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OVERSIGHT OF THE U.S. POSTAL SERVICE

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL SERVICES,
POST OFFICE, AND CIVIL SERVICE

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

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OVERSIGHT OF THE U.S. POSTAL SERVICE

MONDAY, MAY 16, 1988

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL SERVICES,
POST OFFICE, AND CIVIL SERVICE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:08 p.m., in room SD-342, Dirksen Senate Office Building, Hon. David Pryor, Chairman of the Subcommittee, presiding.

Present: Senators Pryor and Stevens.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. The Subcommittee will come to order. I would like to welcome not only the witnesses but also the public who are present for this hearing this afternoon.

Ordinarily I would have scheduled postal hearings earlier in the year, but we have recently come through some rather dynamic periods in the world of postal affairs. With the new Postmaster General taking office in the month of March, the rate increase in April, and, of course, the enactment last December of the budget reconciliation legislation, I thought it might be best to let the dust settle a little bit.

I am going to be asking some fairly hard-nosed questions about postal operations and finances today, and on the 26th of this month, when the new Postmaster General appears before the Subcommittee, we will be asking further questions of him. But I do not want anyone to get the wrong idea about my motives.

While we all concede there are problems with the U.S. Postal Service, I strongly disagree with certain administrative officials who think "privatization"—I think a euphemism for "destruction"—of the Postal Service is the answer. On the contrary, my objective, as Chairman of the Subcommittee, is to strengthen and improve the Postal Service. It is in that spirit that I will both criticize to some extent and compliment to some degree postal operations over the course of these two hearings.

I must say it still amazes me to think that the Postal Service processes 150 billion pieces of mail each year. It is even more incredible, when you think about the vastness of this Nation, 100 million residential and business addresses and how intertwined our complex society is with the U.S. mail.

We look forward with anticipation to our hearing on the 26th when the new Postmaster General, Anthony M. Frank, will appear before this Subcommittee to present the Annual Report to the Con-

gress, as required by the Postal Reorganization Act. Mr. Frank's understandably busy schedule made an earlier appearance impossible.

Also and certainly, we look forward today to hearing from the Postal Rate Commissioners and the General Accounting Office.

I hope that the Commissioners can enlighten this Subcommittee with respect to the apparent disappearance during the recent rate case of what should have been a billion dollar surplus in postal revenues. As for the General Accounting Office, I am very interested in learning more about the process that senior level postal officials went through this past winter in deciding how to achieve the required $160 million in deficit reduction savings.

We now know that one part of the Service's budget that went unscathed and almost untouched was the $1 billion headquarters budget. Instead, while others throughout the organization were being told to tighten their belts, while the mailing public was being asked to accept a 10 percent cut in window service, headquarters of the Postal Service gave itself a 7 percent increase. If senior postal officials had simply held their own budget to its fiscal 1987 level, almost half of the required savings would have been achieved.

I want to welcome our first witness, Chairman Steiger, who is accompanied by Commissioners Tyson, Crutcher, Folsom, and LeBlanc. You may all proceed to the witness table.

Chairman Steiger, we look forward to your statement.

For the audience's benefit, I just had the pleasure of visiting with Chairman Steiger, reminiscing that it was 22 years ago when we were in the same class in the U.S. House of Representatives. That was the late Bill Steiger, and we were in that same class. We made note that several members of that class have become somewhat prominent. One, of course, is George Bush. We hear a lot about Mr. Bush these days. Did we little know at that time, Ms. Steiger, that he would be our Vice President and, who knows, maybe even our President.

We thank you for appearing today.

TESTIMONY OF JANET D. STEIGER, CHAIRMAN, POSTAL RATE COMMISSION,[1] ACCOMPANIED BY COMMISSIONERS HENRY R. FOLSOM, JOHN W. CRUTCHER, WILLIAM H. LeBLANC III, AND PATTI BIRGE TYSON

Ms. STEIGER. Mr. Chairman, recognizing the incredible demands on your time and that of Senator Stevens and the other members of this Committee, we have done our best to truncate and shorten our statement and, with your permission, we will read this somewhat exerpted version of it this afternoon, if that is satisfactory.

It is a pleasure, as always, to be here and to review our recent work at the Postal Rate Commission and to discuss, we hope, some of the significant, very significant postal issues you have raised before us.

Before I begin, I would like to introduce, with great pleasure, our new colleague, Trey LeBlanc. We are finding him a very good addition to our group and we are most pleased to have him join us. His

[1] See p. 25 for Ms. Steiger's prepared statement.

was a difficult chore of coming in mid-stream in the rate case and we think he did very well indeed.

The other of my colleagues are very familiar to you—Henry Folsom on my far left, John Crutcher, and Vice Chairman, Patti Tyson, on my right.

As you would expect, most of the year was devoted to the general rate case. It was the seventh rate case under the current law and with the total revenue requirement of $39 billion, it was the largest rate case in history. We are proud to say we completed it on schedule, Mr. Chairman.

In inviting us to testify, you mentioned a desire to know if we are receiving sufficient information to do our job. In this connection, I must recognize the Postal Service's efforts in the recent rate case to provide us with the data with which to decide that case. Though there have been conflicts in the past, and the Postal Service is still concerned to safeguard proprietary business information, we think this docket gave welcome evidence of a new and more cooperative approach. And of course, the help we got from mailers and other intervenors was equally important, and especially the sophisticated and highly focused evidence they filed. We do not think we have ever seen a higher quality record than was filed in this case.

I know that those who read the headlines think of this simply as the 25-cent letter stamp case and nothing more. As a matter of fact, there was a great deal more to it. One feature that did get media attention was the increase in third-class bulk rates.

No one who followed that case should have been unduly surprised by the outcome as it affected third class. We recommended a third-class bulk regular rate increase averaging just under 25 percent, whereas the Service had requested 23 percent. By comparison, the Service asked for a 15.4 percent increase in first class letters, and we recommended 15 percent. These new rates, I must add, like all of the others, are cost based.

Some of the cost figures indeed may have suggested that the new rates for third class could have been even higher. The record in R87-1 showed a unit attributable cost increase of 30 percent over the previous case. Under the Act we must, however, be careful to consider the impact of increases on the users and so in balancing the pricing factors we were cautious and moderated the pricing effect, in light of the attributable cost increase in third class. Specifically, we reduced its cost coverage from 146 provided for in 1985, the R84-1 rate case, and these new rates, the R87-1 rates, yield about $1.40 in revenue to the Service for each dollar of cost attributed on a causal basis to third class bulk regular mail.

Thus, cost attribution analysis—the most empirical, fact-oriented phase of rate-making—explains why the percentage increase is a bit more than the Service had requested. Two newly developed and we feel highly reliable data bases were presented by the Service, one covering purchased transportation costs and the other letter carrier street time. We and the parties thoroughly analyzed both and each revealed new causal connections between cost elements and the classes.

There is one specific aspect of street time that had a significant affect on third class that will illustrate my point. At almost a quar-

ter of all delivery stops, the carrier has mail of only one class. One important item in carrier costs is the time spent deviating from the basic route the mail carrier travels to reach the addressee's mailbox or letter slot—we call it "access time." Where mail of just one class is delivered at a given stop, it is easy to see that only that class has caused the related access time cost.

Using the newly available data, we found additional attributions from single-class stops of $390.4 million; $161.8 million of this was caused by third class. That $161.8 million equals 46 percent of the increase in its attributable cost. It was a major factor.

Another novel development in this past case was our "shell classification" for a consumer-oriented Courtesy Envelope category. It rests on the idea that a large proportion of house-hold-origin letters are bill payments, subscription renewals, or mail orders, and they are sent in pre-printed envelopes provided by the bank, the store, the publisher or some other business entity.

If prepared with a facer identification mark, a ZIP+4 code and a pre-printed bar code, and if addressed to a box rather than a street address, these envelopes were estimated on our record to save over 5 cents apiece for the Postal Service. Letting the householder who actually pays the postage benefit from those savings means that some of the benefits of automation and the avoidance of carrier street operations will flow to the general public.

This proposal, by the way, was presented by our Office of the Consumer Advocate and, while we could not quantify the volume and revenue effects it would have had, we did decide to recommend it as a "shell classification." It was one of four such classifications we recommended to the Governors in recognition of mailer worksharing and hopefully as an attempt to pave the way for future cost-based discounts to compensate for that work sharing.

Unfortunately, the Governors determined not to accept any of these four. Their decision directs management to explore these rate discounts further, but establishes no timetable for action. It appears that some promising area's of work sharing will not be pursued, at least at the present time.

In another innovation, we extended ZIP+4 discounts for the first time to third-class bulk mail. The Postal Service's proposal to deepen discounts for first class ZIP+4 mail, when fully analyzed, appeared pretty sure to result in discounts exceeding the demonstrated savings. That in our view was just not acceptable ratemaking. But it was equally important in our view to increase the utilization of ZIP+4 automation, and we were able to attempt this by providing an incentive for third class as well as first class mail to bear the necessary markings. This was not a Postal Service proposal, but the Service did not oppose it and indeed in the final round of hearings before our Commission sponsored useful testimony on the proposal.

Quantifying the benefits of automation, which is a subject mentioned in the Chairman's letter to the Commission, is one of the main tasks in any rate case. A great deal of high-quality analytical work has been invested in quantifying the savings, and there has also been some sharp disagreement on how this analysis should be carried out. I can only touch on probably a few of the basic principles here.

First, there is always a presumption in favor of cost-saving innovations. The majority of our mailstream is business mail, which means in effect that most postage expenditures are input costs for something else our economy produces. If we can save postal costs, we become more efficient overall as an economy.

Automation is today in the forefront of these cost-saving efforts, though it is by no means the only one. Secondly, automation, like anything new, has to be judged in large measure by its results. We do not pursue it just because it is new or just because it uses advanced technology. This implies that we have to make realistic comparisons between the benefits from different cost-saving approaches. In some cases, the "low-tech" approach may be more productive.

Finally, just putting new processes into place is not enough to produce benefits—they must be installed and they must be used. Several months ago, a GAO report—we are pleased that we will be able to hear from Mr. Elmore today as well—related some disquieting instances of failures to take advantage of existing ZIP+4 equipment on qualifying mail, with a resulting loss of available savings. This is something, of course, that only management can prevent, but it points up the incompleteness of a savings estimation approach which considers only a hypothetical piece of mail moving through alternative processing streams.

Both for this reason and because such hypothetical studies may err in the other direction by omitting some real-world cost differences, we have been careful to choose the most realistic way possible of quantifying discounts.

To move to more general financial matters, we did not face in this case the problem of predicting what the Service labor rates would be—as you know, the union settlement was signed by the end of July—but there were other big financial uncertainties in this case.

Early in the proceedings, of course, everyone focused on FERS. The Service had assumed, following OMB's lead, that conversion to FERS among pre-1984 employees available would run at 40 percent and it would cost $1.055 billion in the test year. By winter, it was clear that 40 percent was not going to be reached; in mid-January we saw the final figures indicating conversion at only 1.8 percent, and that equated to about $45 million in this rate case in extra 1989 costs. Now, this disparity between prediction and actuality seemingly led to cost avoidance of $1 billion.

Needless to say, a lot of people were hoping for Christmas in March. They were disappointed and said so quite clearly when we recommended a break-even requirement that was not a billion dollars lower than requested. But the Service had provided evidence that in the most recent fiscal year, fiscal year 1987, other costs had risen so much as to wipe out the so-called "FERS dividend."

This made us no happier than it has made others, but a break-even revenue decision on the record entails taking into account these facts, negative though they were, as well as the positives of the retirement savings.

Most disquietingly, the fiscal year 1987 cost containment program fell seriously short of obtaining the planned reductions. This made a difference in the test year of nearly $300 million in antici-

pated savings. But to put the cost increase picture in perspective, I will mention that if initial FERS forecasts had been correct, it is almost certain that a 26-cent stamp and corresponding increases for all other classes would have been necessary. It is facts like this, Mr. Chairman, that led some to conclude that Postal Service costs are truly out of control.

In this connection, I note that the Committee has asked for our comments on the need for and the size of the Postal Service's contingency provision. This was a significant issue in the recent rate case, and I think we made substantial progress toward settling some of the questions that surround it. The fact remains that this billion-dollar item is causing serious and largely justified concern among those who must pay for it.

Of course, some provision for contingency is a requirement of the statute, and the other statutory requirement is that that provision be reasonable. Here, in quantifying what is reasonable, we find the practical issues with respect to the contingency.

In the last case, we clearly distinguished two elements of contingency: one, provision against errors in forecasting the magnitude of known costs or of revenues; and, two, provision against unforeseeable occurrences. Because it rests on a recognition that some occurrences are not foreseeable even in qualitative terms, let alone quantifiable in advance, the contingency is largely committed to postal management's financial judgment as to how much it should ask for.

But that does not mean either that providing for totally unforeseen occurrences should dominate thinking about the over-all size of the contingency, or that the final judgment postal management applies to this unforeseeable component is beyond all and any review. We expect that even where judgment is the main factor, it must be articulated and explained if it is to be the basis of rates.

The rates we recommend must be based on substantial evidence. That legal requirement applies as much to the contingency as to any other part of the revenue requirement. As it now totals over a billion dollars a year, the contingency clearly has a drastic effect on mailers. It is also reasonable to think it has an impact on the Service's own incentive to maximize internal efficiency. In our decision we called for a more objective and systematic way of determining and evaluating the contingency and we intend to pursue that goal.

As you would expect, mailers are disturbed about the general trend in postal cost incurrence, and in particular the Governors' decision to implement the rates on April 3 may have focused attention on the Service's apparently pressing short fall.

Concerned mail users, however, are looking for ways to help control costs, and we are told that groups of mailers are being organized for that purpose and that Postmaster General Frank is also launching new initiatives to the same end. I might add that we have high expectations of these new initiatives. There has not been a new Postmaster General in our experience who has shown a quicker grasp of the really significant concepts and issues.

Whenever the cost of any government program threatens to get out of hand, we begin to hear it said that maybe we need "more oversight," and this question underlies in part the current debate

on whether the Service should be off or on-budget. We do not profess any specialized expertise on the theory of national budgeting. We all have individual views on the question of retaining or removing the Service from the national budget. We do not, however, have an institutional position as a Commission. There is one area, however, affecting not the ultimate question but rather an argument sometimes made in debating it, where we do have the views to offer.

It is sometimes argued that the reason the Service should be on budget is the extra oversight the budget process will provide. But there is more than one kind of "oversight," and it is a fallacy to confuse the external discipline imposed by a national budget or similar process with the internal controls that on-the-spot managers can exercise more effectively than anyone else.

Of course, the presence of external oversight can eventually motivate the institution to police its own affairs better, but for the present we are inclined to believe that any actual gap that exists in the control process is more probably one that Postal Service management rather than outside supervisors must repair.

Better management controls produce more than just isolated improvements; they can also improve day-to-day productivity, which concerns all of us. Without improvement in productivity, few organizations can remain viable in today's competitive world, including monopolies. And you cannot improve if you do not know what you are doing. In the 1970's, the Postal Service used "gross" productivity to measure performance—that was basically the number of pieces of mail handled per employee per work-year, and this factor ignored a host of things, including mailer work sharing, the effects of changes in the mix of mail class, and so on.

In the 1980's, they have shifted to a new productivity measure, known as total factor productivity, which attempts to account for all changes in the postal workplace, and that new factor indicates that postal productivity increased at an average of .3 percent per year since 1972. There are Postal Governors who believe that this performance should be vastly improved if the Service is to remain a competitive force.

The rest of our statement involves upcoming activities which I am sure can be taken as given on the record, and we will not repeat it here, Mr. Chairman, and we would be happy to answer any questions to the best of our ability, sir.

Thank you.

Senator PRYOR. Do any of the other Commissioners have a statement at this time, or would you just be willing to submit to questions or perhaps a written statement for the record?

[No response.]

Thank you very much. I really do need to go into the cost situation in somewhat more detail. I remember so well Postmaster General Tisch, who came before our Subcommittee, said that FERS, the Federal Employment Retirement System, was going to add a billion dollars—I think you have addressed that to some degree—based on the assumption that 40 percent of the Postal employees would switch to that new system. This was one cost element that he discussed, we were told, and that in and of itself would add 1 cent to the price of a stamp, and my question is this: Was this bil-

lion dollars included in the revenue requirement when the Postal Service filed its rate case last year?

Ms. STEIGER. Yes, sir.

Senator PRYOR. And was it attributed to the massive switching of 40 percent of the Postal workers to the new FERS system?

Ms. STEIGER. Yes, sir. Yes, sir, it followed the OMB guideline on that and, in addition, the Postal Service provided their own independent study indicating that the range of conversion could be in the nature of 35 to 51 percent, which they said corroborated their estimate for it.

Senator PRYOR. For the record, thus far how many of the Postal employees have switched to the FERS system?

Ms. STEIGER. 1.8 percent.

Senator PRYOR. 1.8, with an anticipation of about?

Ms. STEIGER. Forty percent.

Senator PRYOR. Forty percent or all the way up to possibly 51 percent.

Ms. STEIGER. Yes, sir.

Senator PRYOR. Why have they not switched to this new system, do we know?

Ms. STEIGER. We do not. Our evidence is anecdotal. I do not even think OMB has done or OPM has done much of a study yet. The question as to whether it was not properly introduced to the worker, whether this worker in the Postal arena had inadequate disposable income or perceived that he or she did, to make the thrift plan, which is necessary if this is going to work well, attractive—we do not really know, but the fact of the matter is we do know that the costs were a billion dollars less than anticipated in the filing before us.

Senator PRYOR. Okay. Now, I would like to look at some of the costs that we define now as "other costs." I think you mentioned around $300 million in other costs. Now, the $300 million was because of what?

Ms. STEIGER. A failure of the cost containment program the Service had presumed in their initial filing. This was a rather simple program in that it was not made up of discrete elements. It was roughly 1 percent of the budget that was to be saved in fiscal year 1987. They failed to achieve anywhere near that goal and, as you roll forward that failure into the test year, the net impact is $290 million. This is the area we found most disappointing, this failure of cost containment.

Senator PRYOR. Why did the program fail?

Ms. STEIGER. There is in our record very little explanation other than the statement it simply did fail, and we do not think things are looking much better for that type of cost containment program in the future.

Senator PRYOR. All right. So there is $300 million in "other costs." Now, how then did we go forward and build in the billion-dollar cost increase that was passed on to the stamp? There is $700 million wiggle room in there, I guess. Where is that other $700 million? What happened there?

Ms. STEIGER. There are three other elements. The labor contract proved to be $400 million more costly in its impact on the test year than was anticipated when they filed in May. Increased health ben-

efit costs came in $160 million above estimates. And, finally, there was a $100 million error that I hate to call an accounting error but I am afraid that is what it was, in which they had both overestimated the revenues from penalty mail and underestimated its costs, and the net impact was a negative $100 million, and those add up, when rounded, to a billion dollars.

Senator PRYOR. So we did not have, as Mr. Tisch maintained last year before the Subcommittee, the $1 billion in increase because of FERS, we did not have that increase, but the other costs increase amounted to roughly a billion dollars?

Ms. STEIGER. That is correct.

Senator PRYOR. That was convenient, because it appears that that could have been passed on as a savings to the consumer, rather than a 25- or 24-cent stamp.

Ms. STEIGER. We found the costs to be real, they had been incurred, and not to recognize them or recognizing a positive on the one side, not to recognize the negatives that had also taken place in this period of time would simply have adjusted the timing of the next rate filing.

Senator PRYOR. Now, had 40 percent of the Federal employees in the Postal Service opted out and gone to the FERS retirement program, are you maintaining then we would have in fact had a 26-cent stamp. Is that your statement?

Ms. STEIGER. Yes, because you would have had to find another billion-plus in revenue and that would just happen to be roughly the cost of another penny on the stamp rolled through. I believe that is reaching $1.2 or $1.3 billion by now.

Senator PRYOR. Tell me about the $1.3 billion contingency fund. What is the contingency fund? Do you take a certain percentage of the overall income, or let us say, the surplus and put it aside? How does this work?

Ms. STEIGER. Well, management in filing determines that the statute gives them the right to the contingency and they will come in with a figure. In this case, it was 3.5 percent of the total revenue requested. That happened to total $1.3 billion in this case. It is very substantial. But 3.5 percent is within the historic range of the contingencies granted to the Postal Service and, in fact, is at the lower end of that range.

We did carefully consider all the evidence and the arguments contributed by parties on this matter. As we noted, while we did not determine that we should adjust that contingency in this case, we expressed concern about being able to better quantify and better analyze the contingency, and we intend to pursue that.

As to the form this contingency takes, it is not a line item expense on Postal Service books; therefore, you cannot look at it being moved from accounting period to accounting period. We can, however, and do retrospectively analyze what happened to that contingency, because when the test year is over with, fiscal year 1989, you will be able to look at their books, you will be able to look at the contingencies you gave them, and you will be able to know how far short the break-even plan turned out to be, and therefore——

Senator PRYOR. The contingency fund, is this the normal level $1.3 billion that you are carrying in a contingency fund?

Ms. STEIGER. The $1.3 billion falls out of the percentage points, so it is a percentage in the increase they have asked for.

Senator PRYOR. But you still have $1.3 billion in a——

Ms. STEIGER. In actual fact, there it is.

Senator PRYOR. All right.

Ms. STEIGER. It shows up as a cost for bookkeeping purposes, but it is real and is actually surplus over break-even.

Senator PRYOR. All right. Could we have used the contingency fund of $1.3 billion to avert a 25-cent stamp, in other words a 24-cent stamp, rather than a 25-cent stamp? What is the contingency fund for?

Ms. STEIGER. Unforeseeable events and problems. Remember, this is a three-year supposed break-even cycle, roughly. It is supposed to be a cycle of more than just the test year; and, secondly, it is for errors in forecasting which cannot be foreseen, and we have separated those two. Our concern and the concern expressed by other Commissioners is that there must be some way to quantify expenses that are now foreseeable in a better manner than we had been able to do so in the past, but it must be separately counted and this contingency is a cost in the rate case. That is in the statute. The statute provides for a reasonable allowance for a contingency, so take it all and apply it to the stamp and we would have run afoul of the statute. It would have taken all of it to reduce the stamp.

Senator PRYOR. Rather than saying to the postal customers of the country "you are going to suffer a 10 percent savings and we're going to take this savings out of window closings, we're going to not open the Helena, Arkansas, Post Office until 9:00, where it has been opening at 8:30 for the last 150 years, we're going to threaten Saturday delivery not being made and things like this," why could you not have used the contingency fund to avert some of those, let us say, inconveniences and cuts that ultimately were passed on to the consumer and the customer?

Ms. STEIGER. We are waiting with interest GAO's evaluation of what the Postal Service did consider as options when it went to closing those windows. We are told they only have saved $9 million a month by doing so. It seems a bit strange that you could cut service before you would cut anything else for $160 million, which is—what is it, .1 percent of their budget—would contingency be useful for exactly that kind of "unforeseeable" circumstances? One would think so. The question is as to whether their economic position or their position on the books was so poor that the contingency was already being used for general operations.

I am reminded that the Budget Act did say that they could not use new rates to cover costs, and presumably contingency could be called part of those new rates, so there may be a problem, an additional problem to what I have suggested in that.

Senator PRYOR. Would you say that again?

Ms. STEIGER. It is our understanding that the Budget Reconciliation Act insisted that they should not use new rates to come up with the savings, contingency being part of the new rate case might run afoul there.

Senator PRYOR. How much money is in the contingency fund right now, $1.3 billion, or is it just built up each year?

Ms. STEIGER. If they do not spend it.

Senator PRYOR. What is in that fund right now?

Ms. STEIGER. What would be in it now at new rates would be $1.3 billion.

Senator PRYOR. $1.3 billion. How rapidly does that increase each month?

Ms. STEIGER. It is just an overall provision to be taken into consideration in obtaining your revenues, so there is not a monthly feature to it. The revenue requirement for the test year includes $1.3 billion for contingency, it is built into the whole rate structure.

Senator PRYOR. Who has jurisdiction over the contingency fund, as to how that fund can be spent? Does the Postmaster General?

Ms. STEIGER. It is not a separate fund.

Senator PRYOR. It is not a separate fund, not treated basically as a trust fund, set out there by itself?

Ms. STEIGER. It is not an escrow or a trust fund. It is simply part of the general postal operating budget.

Senator PRYOR. One of these days I am going to go to school—I am going to take a couple days off to read Postal Service accounting procedures, which has always been a great mystery to me.

Ms. STEIGER. We would appreciate a tutorial when you are finished.

Senator PRYOR. I will bring you all with me. [Laughter.]

Now, I want to ask about something else. I do have a vote and I will wait until the second bell. Back last October, November and December, when the so-called summiteers were meeting to find their way out of the thicket, we talked a great number of times when I was involved in a lot of meetings myself about cutting every conceivable function out of the Postal Service we could, that we might find some extra dollars that would not affect other postal customers and the American consumer generally.

I think those of us in the Congress who dealt with these issues assumed during that period of time that the headquarters or the administrative end of the Postal Service was also going to take some cuts, especially if you cut out window service. It looks to me as though not only were no cuts taken from the administrative side or, let us say, the general headquarters operation, not only no cuts were made but there was a 7 percent increase given to that sphere of the postal operations. Is that true?

Ms. STEIGER. I do not know. We have not seen either the Postal Service's plan for meeting the required cuts——

Senator PRYOR. Do they call that the headquarters budget? The headquarters budget, am I correct?

Ms. STEIGER. As to distinguish it from the regions and presumably——

Senator PRYOR. Yes. I assume the headquarters budget would be mostly that budget up here in Washington or possibly expanded out into the regions, or just Washington?

Ms. STEIGER. I presume it is just Washington.

Senator PRYOR. So the Washington people, not only did they not take a cut, they got a 7 percent increase, is that right?

Ms. STEIGER. I do not know.

Senator PRYOR. Did they add new people here in the Washington bureaucracy? How many? Does anyone know?

Ms. STEIGER. We do not know.

Senator PRYOR. Did they all get pay raises? I mean what happened there?

Ms. STEIGER. We just do not know how they allocated the cuts and who took it. We have not seen that.

Senator PRYOR. Well, I hope GAO can—maybe they are not ready today to state what their theory is, but I would like to know that.

Ms. STEIGER. We would, too, but we do not know it.

Mr. FOLSOM. The accounting that we get from the Postal Service does not have that segregation. In other words, we do not see distinctly what the headquarters would be, what the costs would be, increases or decreases.

Senator PRYOR. As the Postal Rate Commission, do you not have access to those figures?

Ms. STEIGER. Yes, we have access to all of their costs. The problem is we do not know why they chose to reduce costs in Field A and do nothing in Field Y, if that is what they do. We have never seen their game plan for meeting budget reconciliation nor their defense of it. We are very interested, but we have not seen it.

Senator PRYOR. Well, we are going to find that out. It may not be this afternoon, but definitely a week from now. I am vitally interested in that.

Now, let me discuss the off-budget issue. Last week, the House Post Office and Civil Service Committee approved a bill taking the Postal Service off-budget. There are over 300 sponsors of that proposal in the House of Representatives. The House also proposes to triple the Postal Service's debt authority from $10 billion to $30 billion. The Service currently carries about $5 to $6 billion in long-term debt. What happens if the Service goes to $15 or $20 billion more in long-term debt? Is this healthy? Is it dangerous? Should we do it?

Ms. STEIGER. Let me say personally—and I do want the other Commissioners to have a crack at this, because they have strong views—I am very concerned. We are looking at debt service, to use a broad word, in 1989, based on the figures we have in this rate case, of in excess of $500 million for interest on the debt accrued so far, which is about $7.7 billion. We are looking at another $250 million, or roughly that, payment or repayment of the debt. You are looking at around $800 million in costs for borrowing in fiscal year 1989. This is under the current statute, not even adding depreciation, presuming it should be, which would raise that level substantially.

Senator PRYOR. Let me stop you here, if I may, we have a rollcall vote on the Senate floor, and I do have to go vote. While I am gone, maybe the five Commissioners can discuss this and after I get back, we will have a vote from the five Commissioners and it may be 3-to-2, 4-to-1, or 5-to-0, but I will ask you your opinion. [Laughter.]

I will be right back in a few moments.

[Short recess.]

Senator PRYOR. The Subcommittee will be back in order.

We are privileged to have Senator Stevens. Senator Stevens, do you have any statement at this time? We are in the process of doing some questioning of the Commission. You are free to join in

that or to make your statement now, whatever would be your pleasure.

Senator STEVENS. I commend you for holding these hearings, Mr. Chairman. I will just ask to include my opening statement at this point.

Senator PRYOR. Without objection.

[The statement of Senator Stevens follows:]

OPENING STATEMENT OF SENATOR STEVENS

Thank you, Mr. Chairman. First of all, let me commend you on expanding the scope of the annual report of the Postmaster General to Congress. I believe the testimony we will receive from the Postal Rate Commission and the General Accounting Office, the two agencies outside of Congress with the most intimate knowledge of the operation of the Postal Service, will help us set the framework for the later testimony of the Postmaster General.

These hearings are coming at a most propitious time. The events of the past six months have moved postal issues from the back page to the front, thus it is appropriate this committee deviate from it's normal hearing schedule. Last year's congressional action of reducing the Postal Service's operating budget by over 1.2 billion dollars for the next two years, a general postal rate increase, and new leadership (a fourth Postmaster General in five years), has caused a great deal of concern and, indeed, a public outcry. Some have gone so far as to advocate amending the Private Express Statutes. There is a good deal of concern as to whether or not the U.S. Postal Service can come away from the events of the past six months and still control the spiraling costs, while continuing to provide the mail service the public has every right to expect. Concerns such as these will be addressed in the next two days of hearings.

I look forward to these hearings and the expert witnesses that we have scheduled to appear.

Senator PRYOR. I was asking the Commission members, Senator Stevens, about their own feelings on taking the Postal Service off-budget, and we had just made the statement that in the House it appears there is great momentum for doing this and certainly increasing the borrowing authority from $10 to $30 billion. Madam Chairman was actually responding to some questions, and I told her when I came back from the vote I might ask them to have a vote on how they felt about the House action and what the Senate may ultimately do.

Ms. Steiger, would you continue with your answer?

Ms. STEIGER. Yes. What I was saying—and I am sure my colleagues would be delighted to give their views—I do want to stress that we are not experts in what is the best way to finance capital investment, but I am concerned and I am concerned that no one think that borrowing is free. We are seeing now in the rate case figures that are very large. By fiscal year 1989, we expect the Service to have $7.7 billion in debt—this is under their current limit of $10 billion total debt—but the interest expense on that is going to run $531.4 million and that is on an interest rate of about 8.7, and the Service must also retire some $285 million in debt principle in 1989, and added together you are in the range of $800 million—one cent alone on a stamp—and if the total debt were to double, I would expect ceteris paribus, that that amount of debt service would double. These are not inconsequential sums.

I personally feel they should be overseen very carefully. If borrowing is going to continue at this pace, you can see down the road some very substantial obligations on the ratepayer. At this point in time, there is no oversight of the capital program of the Postal

Service other than by the Governors, and I point out our concerns that this is a large amount of money to be incurred.

Senator PRYOR. In the past, the Postal Service has been on-budget and off-budget. Do you have any studies to indicate what happened in those years or those periods when the Postal Service was off-budget versus on-budget, as to what happened to debt structure or to the increase or decrease of overall debt? Do we have any studies along that line?

Ms. STEIGER. Well, certainly the increase in debt has occurred while they have been on-budget.

Senator PRYOR. What part would you say that——

Ms. STEIGER. The increase in debt has occurred while they have been on-budget, for the most part. This is the first substantial borrowing the Postal Service has done in several years. Senator Stevens will be able to tell me what was the last year of a large borrowing. I think it was the early seventies. So this decision to move into borrowing for capital expenditures is relatively recent, it has come about in about the last three to four years as a policy of postal management and they were on-budget at that time.

Senator PRYOR. Senator Stevens?

Senator STEVENS. I am pleased to be here with you today to see you all again.

I have heard it said that if we ever get to the point where third-class mail is more than 50 percent of all mail, that a feeling will develop that the value the public places upon the Postal Service per se will change. Do you see any indications now that the increasing volume of third-class mail is decreasing support for the Postal Service?

Ms. STEIGER. I do not. The Postal Service maintains the public posture that it is not their's to say whose mail should be delivered but, rather, that they must efficiently deliver the mail that is given to them. I think that is probably a fair statement of their job.

There is public outcry I think about growth in bulk business mail. On the other hand, you apparently see a $60-billion plus industry out there and somebody must be using it. Whether tipping between 50 and 40 percent would change the image of the Postal Service, I really do not know. An interesting question is going to be, in the light of these rate increases, whether there is indeed a continued growth in the volume of third-class mail. The jury is out on that, as to whether we are going to see a diminution in growth, a leveling of growth, or a continued even volume. I do not know the answer yet.

Senator STEVENS. Well, the charts I have seen tend to show volume U.S. mail revenue and by only showing these two aspects, and Wayne has seen them, they do not show the lower cost of handling third-class mail the fact and the revenue it produces do not need to, so a percentage, equal total volume.

This has caused an increasing feeling that third-class mail is not paying its own way. There is a growing feeling—and I get this when I go home—that third-class mail is subsidized.

Now, as a result of your last rate increase and what you all have just gone through, is there any subsidy for third-class mailers in this system?

Ms. STEIGER. It is our statutory challenge to see that each class of mail pays those costs and that we find those costs as to the very best of our ability and then that they pay a reasonable part of the fixed, a reasonable portion of the fixed costs of the Postal Service. This rate increase showed new costs incurred by third-class bulk rate mail. We did attribute them. That was in the carrier's street time. New data allowed us to show that access time was being caused but not charged to third class, and we charged it, single-class stops.

In addition to that, they do make a substantial contribution to institutional costs. I mentioned earlier in the testimony that for every $1.40 of revenue taken in from third class, they pay $0.40 in institutional costs. In other words, cost coverage is 140 percent. So we are very satisfied that they are not being subsidized.

You are correct that the growth in this class of mail has been predominantly in the less expensive, most densely pre-sorted mail.

Senator STEVENS. Well, am I correct, do you all believe that I am correct in feeling that if we get to the point where the cost of mail increases to the point where the third-class mailers seek an alternative means of distribution, it is really going to result in a substantial loss to the overall welfare of the Postal Service and increase its costs to the other classes of mail, by definition wouldn't that happen?

Ms. STEIGER. By definition. At this point in time, data in our rate case would indicate that the third-class bulk regular mail is contributing $1.8 billion or nearly $2 billion to overhead costs. If it were all to disappear from the mail stream, even assuming some costs were shed as well, whatever they do not pay in institutional costs, somebody else would have to pay and that would probably be the other large class of mail, first class.

Senator STEVENS. Lastly, Mr. Chairman, I thank you for your allowing me to ask questions right now. I am told that Federal Express, UPS, and other entities that compete with the Postal Service, that over 50 percent of the workforce is casual and that we all know that one of the major issues in the last negotiation period for the labor contract was the issue of the number of casual employees that the Postal Service can hire.

The impact seems to be that as the number of casuals in the Postal Service goes down, labor costs go up. The current wage level, I understand, cannot be more than 5 percent. Have you people studied the impact of casuals on the cost of mail service and its overall impact on competitiveness as far as the Postal Service is concerned?

Ms. STEIGER. I am going to ask Commissioner Crutcher to speak to that. He is more knowledgeable than the rest of us. I would note that there are restrictions due to negotiated contract obligations that prohibit beyond a certain level the use of casual and part-time workers. Question number one is whether the allotted casuals and part-timers are being used to the greatest degree of efficiency possible now. We do not know, since we are not that close to operations.

Number two, whether if indeed particularly in peak mailing times, which might look more like the 4-hour windows that UPS and FEDEX operate under, whether more part-timers would indeed

be economically beneficial is a very real question. I don't know if anybody has addressed it.

Commissioner Crutcher?

Senator STEVENS. I would like to hear from Mr. Crutcher. I do not know the extent to which you have examined this question on how the Postal Service determines what is a fair and reasonable base pay for casuals. In this instance, if the competitors are using over 50 percent casual and the Postal Service is limited to use not more than 5 percent, it would seem to me that their cost base has to be non-competitive.

Mr. CRUTCHER. I think that is exactly right. The total wage costs of the chief competitor of the Postal Service, United Parcel Service, run about 59 percent of total costs, compared to 83 percent for the Postal Service, and it has always seemed to me very logical that you should increase the number of part-time workers and casuals. That is difficult, however, because they are now limited by union contract agreements, and those things would have to change and I presume that could not be done except perhaps by statute. I do not think you would want to do that until the next wage negotiating session comes around, which will now be about two years hence.

Senator STEVENS. In terms of the increased use of casuals in peak hours of major mailing hubs, it would seem that the more casuals would have a greater impact on keeping costs down. Did you do any studies of those?

Mr. CRUTCHER. We have not made any formal studies of those. We did go at one point in our Commission deliberations to Memphis to have a look at the Federal Express operation out there and, as you have surmised, nearly all of those sortation people are part-time people. They come in and work 4 or 5 hours and they are gone. They pay them rather well, but they then do not use them except when they are needed.

Senator STEVENS. Thank you, Mr. Chairman I find that a very interesting problem. The competitiveness of the Postal Service I think is something that should concern us all, in view of the really staggering competition that is out there now as compared to the time we passed the Postal Reform Act.

Thank you.

Senator PRYOR. A final question and then I will have some questions in writing for the panel. Last Friday, the administration, I assume through OPM, sent a recommendation to the Hill that the Postal Service fully fund retirement cost-of-living adjustments for their respective annuitants. This was prepared by OPM. It assumes payments by the Postal Service of $662 million for fiscal year 1990, $645 million for fiscal year 1991, $836 million for fiscal year 1992, and $1 billion in fiscal year 1993.

Now, my problem with this report is—I do not want to argue with the figures—we do not know how they are arrived at those dollar amounts, and I would like to challenge the Commissioners, if they would, to do a little workup and study to see how those amounts were arrived at by OPM. We will be writing OPM also, but perhaps we could track this together.

Ms. STEIGER. We would be happy to try to. They do not give us a figure on the number of retirees. Presumably——

Senator PRYOR. They do not give us how they made the determination for the basis of the dollar amounts. They just said here is what you owe your annuitants and sobeit. I think that we should have a more definitive explanation, and I hope that we can work together to acquire that.

I do have several questions in writing. I have a statement from Senator Jim Sasser, a member of this Subcommittee, and also some questions, I believe, from Senator Sasser for you. We will make those available, and you can respond to those the appropriate place in the record.

[The statement of Senator Sasser follows:]

OPENING STATEMENT OF SENATOR SASSER

Thank you, Mr. Chairman for holding this Postal Service oversight hearing.

Recently, the Postal Rate Commission approved a major rate increase for the Postal Service, raising the cost of a first-class piece of mail to 25 cents.

I registered a number of objections about the size of this proposed rate increase.

I was very disturbed by the size of the "contingency" portion of the rate increase which amounted to almost $1 billion.

I also was very displeased to hear that the Postal Service did not intend to immediately utilize the courtesy envelope concept—a new class of mail that could have cut mailing costs for millions of Americans.

I will be very interested in hearing from the Postal Rate Commission on these two subjects.

The Postal Rate Commission, by terms of the Postal Reorganization Act, is the watchdog with regard to mailing costs, and I want to hear from represenatives of the rate commission as to their views on these two subjects since positive action on both could have yielded considerable savings to the American consumer.

Senator STEVENS. Mr. Chairman, would you yield?

Senator PRYOR. Yes.

Senator STEVENS. On that letter, you are referring to the OPM letter of May 13?

Senator PRYOR. That is correct. Do you have a copy of that?

Senator STEVENS. I do have, and I think it would be very interesting if you would put it in the record.[1] I would like to urge that, in view of the fact that the letter states categorically that the proposed changes are consistent with the bipartisan budget agreement that was reached last fall and it states also that these payments by the Postal Service constitute intergovernmental transfers and as such will not affect the budget deficit, that we schedule this for hearing sometime later.

In other words, there is no budget impact of the request that is made, so it does not seem to me to be one that is an emergency in nature. I would like to go into this because I think it has some long-term impact on rates and may violate the tacit agreement that we had at the time we enacted the postal reform legislation. I would like to go into the history of that and make sure everyone understands its relationship to this request.

Senator PRYOR. Certainly. That is a good suggestion by Senator Stevens.

Thank you very much for appearing.

Ms. STEIGER. Thank you, Senator.

Senator PRYOR. We next will call Mr. L. Nye Stevens, Senior Associate Director, General Government Division, General Account-

[1] See p. 79.

ing Office. I believe Mr. Stevens is accompanied by Mr. William Elmore, Group Director, and Mr. Leonard Hoglan, Evaluator.

Mr. Stevens, I am going to momentarily depart the room and Senator Stevens will chair. I will be back in about 5 or 6 minutes, and you may continue with your statement.

Mr. STEVENS. That is fine, Senator.

TESTIMONY OF L. NYE STEVENS, SENIOR ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY WILLIAM L. ELMORE, GROUP DIRECTOR, AND LEONARD G. HOGLAN, EVALUATOR

Mr. STEVENS. Mr. Hoglan, whose name has been mentioned, is in charge of the budget compliance work that we are doing and that we will be spending a good deal of time talking about today.

Mr. Elmore, on my right, has been in charge of our work at the Postal Service audit site since 1979, so is probably the most knowledgeable person we could bring to bear on these problems.

If it is all right with you, Senator Stevens, I would like to summarize what is a fairly lengthy statement here and submit the longer one for the record.[1]

Senator STEVENS [presiding]. We have both the summary and the longer statement. We will print the longer statement in the record and you may proceed as you wish.

Mr. STEVENS. Okay. I will just touch on what we are doing here. We do believe that when the new Postmaster General, who was the fourth in the past three years, came into office he faced quite a challenge, an intensified effort by some to privatize the postal function, restrictions on the operating and the capital budgets for fiscal years 1988 and 1989. There was a challenging public relations environment of customers who had just experienced a curtailment of services at the same time that they are paying more for postage, and from local communities who abruptly saw a postponement of plans for construction of new post offices. And all of this has occurred along with increases in the mail volume and the number of employees and in the cost of processing mail.

In order to assure that the customers get the best possible service, we believe it is going to require continued cooperation between management and labor to address the issues effectively so that quality service can be provided at a reasonable price.

I should mention that all of the work that we have done at the Postal Service for the past five years has been in response to specific congressional requests. We have not been able to initiate any work on our own. This has led us, however, into a variety of matters.

We have got on-going work that covers the acquisition of land for post offices, employee discipline, treatment of employees who were injured on duty, screening of applicants for postal employment and then handling the probationary period when they are first hired, the procurement of multi-line optical character readers, mailings by religious organizations, reduction in window hours in the State

[1] See p. 57.

of Ohio, and how the Postal Service dealt with the tragedy in Edmond, Oklahoma.

In addition, we began the compliance evaluation required by the Budget Reconciliation Act, work that Mr. Hoglan is in charge of, and related work on the headquarters budget that this Committee has requested, looking to alternatives to the cuts that were made.

The statement covers five recent reports that we have issued. I think I will let the written statement cover those. Two of them were on cluster boxes and their use, one that was referred to by Chairman Steiger on ZIP+4 mail processing and our finding that about $25 million of the $28 million that was provided in discounts for ZIP+4 mailing was provided for mail that did not actually go through the automated process; a report on the postal forums and the contribution that the Postal Service makes to the costs of that gathering; and, then, finally, a report that was issued just last week on procurement, looking at the major procurements of the Postal Service, in which we found weaknesses in 44 of the 109 large procurements that we examined.

I will be glad to respond to any questions on any of the reports, but let me get into the budget reduction question which has certainly generated the most contemporary controversy.

As you know, for the first time since the Postal Reorganization Act in 1970, last December's Budget Reconciliation Act imposed mandatory restrictions on both the capital and the operating budgets of the Postal Service for fiscal years 1988 and 1989.

The capital budget commitments were cut about 73 percent from the levels that the Postal Service had planned for 1988, not the numbers that are reported to OMB but its actual internal plans, and about 24 percent for 1989.

With regard to the operating budget, the required reductions were $160 million for fiscal year 1988, and $270 million for 1989. The plan showing how the Service intends to achieve the required savings was required to be submitted to the Congress, and in fact we have appended those plans to the statement here and added to them the dollar amounts for each of the 10 elements that are not actually part of the commitment or the plan that the Service made to the Congress, but it is useful information particularly for our analysis.

In doing this, the Service had to take into account that by the time the Act passed, the fiscal year was nearly one quarter over and thus the working group that they formed to impose the budget cuts emphasized prospective changes that could be very quickly implemented and would produce immediate savings.

The 1988 plan, as I mentioned, is attached to my statement and we have added the dollar amounts to it. As shown in the attachment, the anticipated savings, if you add all those numbers up, come to about $173.8 million. There is a buffer in there of about $13.8 million over the $160 million that the Reconciliation Act required.

More than $100 million of the anticipated savings are expected to come from two of the actions: One, a series of belt-tightening reductions in such administrative costs as training and travel, and the second in window service hours.

I should point out, as was emphasized in the Chairman's opening statement, that all of the reductions were levied on the Services' field offices. The headquarters 1988 administrative budget, $1 billion this year, an increase of 7 percent over the previous year, was not reduced at all. And as agreed with the staff of the Committee, we are looking into this budget; we are analyzing it and looking for possible alternatives within that particular budget to the controversial window service cuts that have gained some attention.

We were particularly asked to report to you on what the Postal Service considered doing as alternatives for budget cuts and did not do. They considered a number of other cost savings, some of which are still under consideration for 1989. In general, they rejected them because they would not produce enough verifiable savings—and that word "verifiable" is important—that they would take too long to get underway, that they would run counter to service improvements that the Postal Service had achieved fairly recently, or that they would be too unpopular.

Some of the more unpopular options included closing small post offices, switching from door to curb delivery, and centralizing all new deliveries to cluster boxes.

Another proposed change involved holding some letter mail an extra day at processing points, to maximize the use of available automated equipment, but that would have meant that some first class mail was arriving a day later than it is now. While the Service estimated that this could save $130 million in 1988, it considered the effect on mail service to be a major drawback, but that would have nearly covered all that the Budget Act required them to cover.

The Service also considered offering early retirement, but the possible savings from this in their analysis were not considered large enough compared to the potential disruption from the loss of the Service's most skilled employees. It saw as a disadvantage the requirement that it would have to offer early retirements across the board and not be able to target them on positions that they felt they could dispense with most easily.

In the previous testimony, the question of casual employees came up—you raised this, Senator Stevens—and they did give thought to raising the proportion of casual employees as a money-saving measure. They are paid about a third of what permanent employees make when you add the benefits and salaries together. The casuals get no benefits except social security.

While the maximum number of casual employees is generally limited by collective bargaining agreements to 5 percent of the workforce, they are not at that level now. The Postal Service is presently below the ceiling; in fact it is below 3 percent at the present time. In spite of this, the Service did conclude that casual utilization was at its highest practical level—we can go into some of their reasoning for that if you would like—not readily expandable at present wage rates and had the further disadvantage of possible contention with the union, since that is usually a contentious issue with the unions.

As I mentioned, we are looking at other cost reduction possibilities, particularly in the headquarters budget, and we expect to have a report available in July to you on that.

That concludes the prepared statement. I will be glad to respond to any questions that either of you have with the help of my colleagues.

Senator STEVENS. I have to leave, Mr. Chairman, and if I might just comment.

Senator PRYOR [presiding]. Surely.

Senator STEVENS. I have reviewed your review of mandated reductions under the Budget Act. I do not find any comment from you as to whether or not the action taken by the Congress last December in mandating those reductions was consistent with the original Act, the Postal Reform Act. Did you ever study that question?

Mr. STEVENS. We did not really study that question. We have discussed it among ourselves at GAO. The Postal Reorganization Act did not really deal with the question of whether the Postal Service should be considered either on-budget or off-budget.

Senator STEVENS. No, and the President originally kept it off-budget and we assumed through the period of time that it was going to be off-budget and it went back on-budget with——

Mr. STEVENS. That was an administrative decision.

Senator STEVENS [continuing]. And now we are back in the pickle and I just wondered from the point of view of consistency—of course, this raises the policy question, I guess, and I probably should not get you involved in that, but it does seem to me that the impact of what we did mandated inefficiencies in the Postal Service in order to achieve a budget goal which by definition they were not involved in. I never could quite——

Mr. STEVENS. I think we could agree with that. In fact, the Comptroller General is planning to make a statement before the House Government Operations Committee on the budget question particularly related to the Postal Service. I think our view is that the budget could be much improved. We like the unified feature, but we agree that the treatment of capital expenditures along with operating expenses is not a sound practice and does lead to misallocation of resources.

Senator STEVENS. Thank you. Thank you, Mr. Chairman. Thank you very much.

Senator PRYOR. Thank you, Senator Stevens. Thank you very much.

You state or you indicate, I should say, that the $1 billion headquarters budget—I call it headquarters budget—was up 7 percent over last year. It went untouched when the search was on for ways to save the $160 million that was required for reconciliation. Now, this is your finding, is this correct?

Mr. STEVENS. Yes, sir.

Senator PRYOR. Why did they not cut the headquarters budget?

Mr. STEVENS. Of course, we have asked them that. It was a glaring finding. The response we get is that they did cut it from the requests. The requests for the current budget year, when they came in from the operating groups, were about 19 percent higher than the budget they were operating under last year.

They wound up—and apparently it was a contentious process—cutting about 12 of that 19 percent, but still leaving an overall increase of 7 percent. That was also something that took place fairly

late in the game. It was almost coincidental with the congressional action around Christmas, and I do not think they had the stomach to reopen those questions just so recently closed when the Congress acted.

Finally, they point out that this is less of an increase than has been allowed in the past. However, having said all that, I believe that we will find some savings that can be achieved there. If they had only held level the amount that they spent the year before, which is not unreasonable in a budget environment like this one, they would have met their target.

Senator PRYOR. In other words, did they get a 7 percent increase in new dollars for headquarters?

Mr. STEVENS. Yes, sir.

Senator PRYOR. How was this allocated, these new dollars? Where were these allocated dollars?

Mr. STEVENS. They are in a variety of functions. Most of the functions got an increase. The overall average was 7 percent. I think we could provide for the record what budget accounts were the highest, but I think most of them went up. A few went down a bit.

[The information referred to follows:]

Salaries and benefits, accounting for about 58 percent of the $1 billion, went up about 9 percent. Other increases include supplies and services (7 percent) and communication (30 percent). Travel expenses came down about 12 percent.

Senator PRYOR. Did they hire new people?

Mr. STEVENS. A few new people were hired. Our information is that there were about 30, but it also included increases, salary increases and bonuses which were not restricted.

Senator PRYOR. How much did they anticipate by window closing and fewer hours serving the public that they would save?

Mr. STEVENS. I believe that was $40 million from the window closing action.

Senator PRYOR. Have they simply held headquarters to its 1987 fiscal year level, I believe they would have saved about $70 million?

Mr. STEVENS. Yes, sir, $66 million exactly.

Senator PRYOR. So they closed down the public service to a degree to save $40 million, but increased their own headquarters operations by $70 million. We will be asking the Postmaster General about that.

Now, the Service is implementing, I understand, a new procurement system. It looks as though it is going to allow greater administrative discretion and will require less competition. Do you think the system is going to require less competition?

Mr. STEVENS. Yes, sir, it certainly——

Senator PRYOR. I am concerned and always have been about sole-source contracting. I think this tends to build an extremely cozy relationship between the private sector and the government entity. Do you anticipate or predict we will see more sole-source contracting under the new procurement system?

Mr. STEVENS. I think it is contemplated by the new manual. Yes, sir, I think they accept that. They are in fact going to a new standard which does not call for full and open competition, but adequate competition from qualified vendors. They pre-qualify vendors to a

select group, and that is expected. It is more efficient, Mr. Chairman. I think that is basically their rationale for it. It does have associated risks, one of which is it is not nearly as likely to be fair, which is not an obligation that private sector procurement functions undertake, as we do in government. The Postal Service, as you know, is somewhat in between.

Senator PRYOR. Looking down to the 1986 figures, in your procurement report, I noticed a $3 million contract to the Wedtech Corporation. Wedtech has been in the news at some degree lately. That was a sole-source contract, there was no competition, is that correct?

Mr. STEVENS. I believe there were two Wedtech contracts. The 1986 one I believe was sole-source.

Senator PRYOR. Was that a $3 million—if you could, just give us those two Wedtech sole-sources and add them up, if you would.

Mr. STEVENS. Yes, the one in 1985 was sole-source—excuse me—that was a $5 million contract for mail containers. The 1986 contract, $2.8 million, also for mail containers, was a negotiated contract, in which there were negotiations with other suppliers, but Wedtech prevailed.

Senator PRYOR. When I came up here to the Senate in 1979, one of my major hangups was that we were doing government business—to a large degree, this was the General Services Administration—with a New Jersey based firm, Art Metal. Art Metal had had a long history of not complying with Federal regulations, delivering faulty materials and just ultimately getting millions and millions of dollars in contract, many of which were not competitively bid.

I see where the Postal Service is still doing business with Art Metal. In fact, they got a $1.4 million contract. Was that a sole-source contract?

Mr. STEVENS. No, that in fact, Mr. Chairman, was a fully competed contract and Art Metal won it in competition with others. They are following rules very comparable to those required in the Federal Acquisition Regulations, in contrast to the Wedtech matter. In the Wedtech matter, there was a postal inspector who has pleaded guilty to a felony in connection with that one. The Art Metal one, we found no comparable problems. In fact, it was not among the 44 that we felt the Postal Service itself had done a bad job on.

Senator PRYOR. Is there a flagging system or some sort of signal triggered when a firm such as Wedtech or Art Metal sends in a procurement bid?

Mr. STEVENS. The Executive Branch has the capability of debarring prospective contractors. I believe Art Metal is presently debarred from Executive Branch procurement.

Senator PRYOR. It has taken about 10 years, I think, to see that.

Mr. STEVENS. It has taken a while, yes, sir. The new Postal Procurement Manual would allow the Postal Service a good deal more freedom than the Executive Branch now has to say this contractor has not done the job for us in the past, and we will not accept bids even if they are lower than other competitors in the future.

Senator PRYOR. I raised the concern some months ago, Mr. Stevens, about a meeting the Postal Service sponsored, and I assumed paid for, for some 300 Postal Service officials at the Showboat

Casino in Atlantic City. That meeting resulted in my asking GAO to check on the use of rented limousines for shopping trips, et cetera. Do you have anything to report at this time? Have you been able to confirm that the casino meeting and limo use did in fact occur?

Mr. STEVENS. We have certainly confirmed that the meeting in Atlantic City did take place. The Postal Service has provided us with some information that showed that at least the room and board charges were somewhat less than a 1986 meeting held in Philadelphia. It was an off-season meeting. The overall costs of it by their estimation were about $86,000.

The limousine matter about which you asked us was really another meeting in Virginia Beach, which Mr. Elmore attended. I think he can give you an eyewitness account of that.

Mr. ELMORE. The use of limousines occurred at the Eastern Regional Forum that was held in Virginia Beach last October. I was at the Forum——

Senator PRYOR. October of 1987?

Mr. ELMORE. October of 1987, yes, sir. I was at the Forum and I can confirm that the——

Senator PRYOR. Did you have a limousine?

Mr. ELMORE. No, sir. I can confirm that there were cars available for postal officials and Postal Forum people to travel to and from the hotels and the convention center. Now, the question is—and I do not know the answer—who paid for it. The National Postal Forum, Inc., may have paid for it or the Postal Service may have paid for it. The Postal Service makes a substantial contribution each year to the Forum.

Senator PRYOR. You know, when we are up here saying that the customers out there are going to get less service, we are going to increase the rate and this sort of thing is going on it is terribly difficult for us to justify. In fact, we cannot justify it. I would appreciate any other information that you have on it. I know that the Subcommittee would appreciate it.

We have several other questions. Senator Sasser will have questions and a statement for the record. I just spoke with Senator Lawton Chiles, who now has an amendment on the floor of the Senate, and he will have some questions for the General Accounting Office.

Mr. Stevens, I want to thank you and your colleagues for appearing this afternoon. Once again, the General Accounting Office has performed a real service, and we are very much indebted to you.

Mr. STEVENS. Thank you, sir.

Senator PRYOR. Thank you very much. The hearing will be concluded.

[Whereupon, at 3:10 p.m., the Subcommittee was adjourned.]

APPENDIX

STATEMENT OF CHAIRMAN JANET D. STEIGER, POSTAL RATE COMMISSION,
BEFORE THE SUBCOMMITTEE ON FEDERAL SERVICES, POST OFFICE,
AND CIVIL SERVICE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
UNITED STATES SENATE

(May 16, 1988)

Chairman Pryor and Senators:

It is a pleasure to meet with you this afternoon, to review our recent work at the Postal Rate Commission and discuss some significant postal issues you have raised. Before I begin, however, allow me to introduce officially our newest Commissioner, Trey LeBlanc, who joined us last winter in the midst of the rate proceeding. My other colleagues, Patti Tyson, John Crutcher, and Henry Folsom, are of course old acquaintances.

Docket R87-1 -- Issues and New Rates. As you would expect, much of the year was devoted to the general rate case. It was the seventh rate case under the current law; the total revenue of $39 billion also made it the largest. We completed it on schedule.

In inviting us to testify, Chairman Pryor mentioned a desire to know if we are receiving sufficient information to do our job. In this connection, I must recognize the Postal Service's efforts in the recent rate case to provide us the data with which to decide it. Though there have been conflicts in the past, and the Service is still concerned to safeguard properly confidential

business information, this docket gave welcome evidence of a new and more cooperative approach. Of course the help we got from mailers and other intervenors was equally important, and especially the sophisticated and highly focused evidence they filed. I do not think we have ever had a higher-quality record in one of our rate cases.

Those who just read the headlines think of this as the "25-cent letter stamp" case and nothing more. In fact, there was a great deal more to it. One feature that did get some media attention was the increase in third-class bulk rates. Not just the specialized postal and marketing newsletters, which have minutely analyzed them, but also the daily papers focused on the story.

No one who followed the case should have been unduly surprised by the outcome as it affected third class. We recommended a third-class bulk regular rate increase averaging just under 25%, whereas the Service had proposed approximately 23%. By comparison, the Service asked for a 15.4% increase for First-Class letters, and we recommended 15.0%. I have included in Attachment A to my prepared statement the recommended increases, and compared the Service's proposals, for a number of classes; you will see that third-class regular had the second-highest. These new rates, like all others, are cost-based.

Some of the cost figures indeed might suggest that the new rates for third class could have been higher still. The R87-1

record showed a unit attributable cost increase of 30% over the previous case. Under the Act, however, we also must consider the impact of increases on users; here we were careful, in balancing the pricing factors, to moderate the price effect of the attributable cost increase in third class. Specifically, we reduced its cost coverage from the 146 provided by the 1985 rates. (Comparisons before 1985 can be misleading, because for several years costing procedures depended on a now-superseded legal interpretation leading to higher levels of attribution and correspondingly lower cost coverages for all mail.) The R87-1 rates are set with a cost coverage of 140 -- that is, they yield about $1.40 in revenue to the Service for each dollar of cost attributable on a causal basis to third-class bulk regular mail.

Thus cost attribution analysis -- the most empirical, fact-oriented phase of ratemaking -- explains why the percentage increase is a bit more than the Service had requested. Two newly developed, reliable data bases were presented by the Service. One covered purchased transportation costs; the other, letter carrier street time. We and the parties thoroughly analyzed both, and each revealed new causal connections between cost elements and classes. We explained these in detail in the opinion. Interestingly, they led to increased attribution of delivery costs but lowered the purchased transportation attribution level.

There is one specialized aspect of street time analysis, significantly affecting third class, that illustrates my point. At almost a quarter of all delivery stops the carrier has mail of

only one class. One important item in carrier costs is the time spent deviating from the basic route to reach the addressee's mailbox or letter slot -- "access time" is the technical term. Where mail of just one class is delivered at a given stop, it is easy to see that only that class has caused the related access time cost. If that class did not exist, for example, then the carrier would have gone straight by, not deviating from the route and so incurring no access time cost.

Using the newly available data, we found additional attributions from single-class stops of $390.6 million; $161.8 million of this was caused by third class. That $161.8 million equals 46% of the increase in its attributable cost. The rest results from similarly cost-based changes reflecting new and more meaningful data and analyses.

The Courtesy Reply Envelope proposal. Another novel development was our "shell classification" for a consumer-oriented Courtesy Envelope category. Open to properly marked and barcoded return envelopes, it rests on the idea that a large proportion of household-origin letters are bill payments, subscription renewals, or mail orders. Many of these are sent in preprinted envelopes provided by the bank, store, or publisher. If prepared with a facer identification mark, a ZIP+4 code and a preprinted barcode, and if addressed to a box rather than a street address, these envelopes were estimated to save over five cents apiece for the Service. Letting the householder who actually pays the postage benefit from these savings means that

some of the benefits of automation and the avoidance of carrier street operations will flow to the general public.

This proposal was presented by our Office of the Consumer Advocate. We could not quantify the volume and revenue effects it would have, but we did decide to recommend it as a "shell" classification: that is, a distinct rate category without -- for the present -- a distinctive rate attached to it. It was one of four classification changes we recommended to the Governors to recognize mailer worksharing and pave the way for future cost-based discounts to compensate it. Unfortunately, they determined not to accept any of the four. Their decision directs management to explore these rate discounts further, but establishes no timetable for action and it appears that some promising areas of worksharing will not be pursued, at least for the time being.

ZIP+4 discounts for third class. In another innovation, we extended ZIP+4 discounts, for the first time, to third-class bulk mail.

The Postal Service proposal to deepen discounts for First Class ZIP+4 mail, when fully analyzed, appeared pretty sure to result in discounts exceeding the demonstrated savings. That is generally not acceptable ratemaking. But it is equally important, in our view, to increase the utilization of ZIP+4 automation. We were able to attempt this by providing an incentive for third-class as well as First Class mail to bear the necessary markings. While this was not a Service proposal, the

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Service did not oppose it and indeed, in the final round of hearings, sponsored useful testimony on the proposal.

Quantifying the benefits of automation, mentioned in Chairman Pryor's letter as of interest to the Committee, is thus one of the main tasks in any rate case. To some degree, getting any benefit from automation requires the mailer's cooperation; therefore we turn over part of the savings as a discount. A great deal of high-quality analytical work has been invested in quantifying the savings, and there has also been some sharp disagreement on how this analysis should be carried out. I can only touch on a few basic principles here.

First, there is always a presumption in favor of cost-saving innovations. The majority of our mailstream is business mail, which means in effect that most postage expenditures are input costs for something else our economy produces. If we can save postal costs -- which are a significant item in the GNP -- we become more efficient overall. Automation is today in the forefront of those cost-saving efforts, though it is by no means the only one. Second, automation, like anthing new, must be judged in large measure by its results. We do not pursue it solely because it is novel or uses advanced technologies. This implies that we must make realistic comparisons between the benefits from different cost-saving approaches. In some cases, the "low-tech" approach may be more productive. Finally, just putting new processes into place is not enough to produce benefits -- they must be installed *and used*. Several months ago a GAO report related some disquieting instances of failure to

take advantage of existing ZIP+4 equipment on qualifying mail, with a resulting loss of available savings. This is something only management can prevent, but it points up the incompleteness of a savings estimation approach which considers only a hypothetical piece of mail moving through alternative processing streams. Both for this reason, and because such hypothetical studies may err in the other direction by omitting some real-world cost differences, we have been careful to choose the most realistic way possible of quantifying discounts. You will see rather elaborate findings on those issues throughout the R87-1 decision; we think they contribute significantly to a sound and productive postal automation policy.

Postal finances after Docket R87-1. Let's move from strictly ratemaking issues to some more general financial matters.

While we did not face the problem of predicting what the Service's labor rates would be -- because a union settlement was signed by the end of July -- there were other big financial uncertainties in the case. Early in the proceeding, of course, everyone focused on FERS. The Service had assumed, following OMB's lead, that conversion to FERS among pre-1984 employees would run at 40 percent and to cost $1.055 billion in the test year. We obtained monthly readings from the Postal Service on the rate of conversion. By the winter, it was clear that 40% was not going to be reached; in mid-January we saw final figures indicating conversion at only 1.8% corresponding to $ 45 million

in extra 1989 costs. This disparity seemingly led to a cost avoidance of $ 1.0 billion.

Needless to say, a lot of people were hoping this would lead to Christmas in March. They were disappointed, and said so quite clearly, when we recommended a breakeven revenue requirement that was *not* a billion dollars lower than requested. But the Service had provided evidence that in the most recent fiscal year (FY87) other costs had risen so much as to wipe out the so-called "FERS dividend."

This made us no happier than it made others -- but a breakeven revenue decision on the record entails taking into account those facts, as well as the retirement savings. The Service was right in arguing that if we recognized one aspect of actual FY87 operations we must recognize the others too.

Most disquietingly, the FY87 cost containment programs fell seriously short of obtaining the planned reductions. This made a difference in the test year of nearly $300 million in anticipated savings. But to put the whole cost-increase picture in perspective, I may mention that if initial FERS forecasts had been correct, it is almost certain that a *26-cent* stamp, and corresponding increases for other classes, would have been necessary. It is facts like this that have led some to conclude that Postal Service costs are truly out of control.

In this connection, I note that the Committee has asked for our comments on the need for and size of the Service's

contingency provision. This was a significant issue in the recent rate case, and I think we made substantial progress toward settling some of the questions surrounding it. The fact remains that this billion-dollar item is causing serious and largely justified concern among those who must pay for it.

Of course, *some* contingency provision is a requirement of statute; it is declared to be one of the "costs" which rates (along with appropriations income) must be set to recover. The other statutory requirement is that it be "reasonable." Here, in quantifying what is reasonable in a given case, and indeed in devising basic methods for judging reasonableness in all cases, we find the practical issues with respect to the contingency.

In the last case, we clearly distinguished two elements of contingency: provision against errors in forecasting the magnitude of known costs or of revenues, and provision against unforeseeable occurrences. The latter we may think of as a built-in bias against any operating deficits. Because it rests on a recognition that some occurrences are not foreseeable even in qualitative terms -- let alone quantifiable in advance -- it is largely committed to postal management's financial judgment how much to ask for.

But that does not mean either that providing for totally unforeseeable occurrences should dominate thinking about the overall size of the contingency, or that the financial judgment postal management applies to the unforeseeable component is beyond all review. We expect that even where judgment is the

main factor, it must be articulated and explained if it is to be the basis of rates. The rates we recommend must be based on substantial evidence. That legal requirement applies as much to the contingency as to any other part of the revenue requirement. As it now totals over $1 billion a year, the contingency clearly has a drastic effect on mailers. It is also reasonable to think it has an impact on the Service's own incentive to maximize internal efficiency. In our decision we called for a more objective and systematic way of determining and evaluating the contingency. We will pursue that goal.

Postal Service cost control. As you would expect, mailers are disturbed about the general trend in postal cost incurrence. In particular, the Governors' decision to implement the rates on April 3, which precipitated a lawsuit, may have focused attention on the Service's apparently pressing shortfall. Concerned mail users, however, are looking for ways to help to control costs, rather than simply blaming the Rate Commission, or each other, for increases in their rates. We are told that groups of mailers are being organized for this purpose, and Postmaster General Frank is also launching new ideas with the same end. I might add that we have high expectations from these initiatives; no new Postmaster General in our experience has shown a quicker grasp of the really significant concepts and issues.

Whenever the cost of any government program threatens to get out of hand, we begin to hear it said that maybe we need "more oversight." This question underlies, in part, the current debate over whether the Service should be on- or off-budget. We do not

profess any specialized expertise on the theory of national budgeting. We do all have individual views on the question of retaining or removing the Service from the national budget, but we do not have an institutional position as a Commission. There is one area -- affecting not this ultimate question but rather an argument sometimes made in debating it -- where we do have views to offer.

Sometimes it is argued that the reason the Service should be on budget is the extra oversight the budgeting process will provide. But there is more than one kind of "oversight," and it is a fallacy to confuse the *external* discipline imposed by a national budget or similar process with the *internal* controls that on-the-spot managers can exercise more effectively than anyone else. Of course the presence of external oversight can eventually motivate the institution to police its own affairs better; but for the present we are inclined to believe that any actual gap that exists in the control process is more probably one that Postal Service management rather than outside supervisors must repair.

Better management controls produce more than just isolated improvements; they can also improve day-to-day productivity, which concerns all of us. Without improvement, few organizations can remain viable in today's competitive world, including monopolies. And you can't improve if you don't know how you are doing. In the 1970s, the Postal Service used "gross" productivity to measure performance -- the number of pieces of mail handled per employee work year. This factor ignored the

effects of mailer worksharing, such as presortation, the effects of changes in the mix of mail classes, such as a reduction in higher cost parcel post and an increase in lower cost carrier-route presorted third class, the effects of new services, and the effects of population density on productivity. In the 1980s the Service shifted to a new productivity measure, known as total factor productivity, which attempts to account for all changes in the postal workplace. The new factor indicates that postal productivity increased at an average 0.3% rate per year since 1972. Some Postal Governors believe that this performance should be vastly improved for the Service to remain a competitive force.

Upcoming activities. Let me conclude with a brief outline of some of our own plans for the near future.

In one major ratemaking area, the state of our information -- and the techniques that depend on it -- is not altogether satisfactory. That is the estimation of Postal Service volumes. In our Docket R87-1 opinion we made it plain that we are dissatisfied with the econometric methods the Service has been using. We are looking into how we can bring about improvement.

Recently the Service filed with us a petition for a rulemaking to develop procedures for rapid rate changes in Express Mail. The Service argues that Express Mail is a competitive offering, which must meet price reductions by other providers. We of course cannot discuss the merits of this pending matter, but it does promise to be a challenge to

everyone's ingenuity. We certainly can provide expeditious procedures, as long as the statutory right of parties to an on-the-record hearing is respected -- as we did a few years ago in enacting rules for "experimental" classification cases. Here, one basic challenge is reconciling the requirements of a due-process hearing (which is in the Service's interest as much as anyone else's) with the notion that in a competitive market price changes intended to respond to competition must be made quickly.

That concludes my prepared statement. We will all be happy to respond to your questions.

Attachment A

SUMMARY OF RATE CHANGES
USPS PROPOSED AND PRC RECOMMENDED RATES

Mail Category	Percentage Rate Change	
	USPS Proposed	PRC Recommended
First Class:		
Letters	15.4	15.0
Cards	15.2	7.3
Total	15.4	14.8
Priority	6.9	3.9
Express Mail	(8.7)	1.9
Second Class:		
In-County	9.6	17.9
Outside		
Nonprofit	18.9	23.7
Classroom	9.3	16.5
Regular Rate	13.9	18.1
Third Class:		
Single Piece	12.3	12.2
Bulk Regular Rate	22.9	24.9
Bulk Rate Nonprofit	0.8	6.9
Fourth Class:		
Parcel Post	12.1	14.8
Bound Printed Matter	20.6	17.8
Special Rate	26.7	34.9
Library Rate	13.1	20.6

ANSWERS TO QUESTIONS FROM SENATOR SASSER

[1.] Ms. Steiger, in its "Opinion and Recommended Decision," issued March 4 of this year, the Postal Rate Commission remarked that "nearly one-third of the recommended rate increase is for an allowance for contingencies. Several parties raised serious questions about whether such a large contingency undercuts efficient management; and suggestions were made as to how the Governors might more scientifically estimate the magnitude of this item in the future."

Now, if I understand those comments correctly, the contingency allowance certainly does tend against efficient management. The Postal Service is planning down to the dollar. In this or that community, it cuts window hours. In another region, it switches mail cargo from aircraft to slower ground transportation, all to save money. And now we hear that a third of its latest rate increase is set aside, in effect, for a cushion. Why did the Commission approve so large an increase, if you were concerned about it?

1. First, we should clarify that the contingency -- while it is indeed arithmetically equal to about a third of the revenue increase recommended[1] -- is not solely associated with the increase. It is calculated on the *entire* revenue requirement, which in this case amounted to some $39 billion. It is not the case that the old rates did not contain a component for contingency; they did, and thus the $1.3 billion contingency represents the R87-1 implementation of a constant feature of postal rates under the Postal Reorganization Act.

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[1] The contingency recommended and adopted by the Governors amounts to roughly $1.3 billion per year. The total revenue increase recommended to meet costs (after allowing for the volume-reducing effect of higher rates) is about $4.3 billion, or 3.3 times the size of the total contingency.

The contingency provision owes its existence to §3621 of the Act (39 U.S.C. §3621):

> . . . Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service. For purposes of this section, "total estimated costs" shall include (without limitation) . . . a reasonable provision for contingencies.

Thus the Commission is not free to eliminate contingency from the revenue requirement. How far it may adjust the contingency proposed by the Postal Service has been a question since *Newsweek, Inc.* v. *U.S. Postal Service*, 663 F.2d 1186 (2d Cir. 1981), where the court interpreted the Act to bar the Commission from changing the revenue requirements (including the contingency) where the purpose or necessary result of the change would be to alter the Governors' financial management policies. Of course, the contingency asked for must still be "reasonable"; in the most recent case, it was -- at 3.5% -- well within the range of figures adopted in the recent past.[2] As the Commission explained in its Opinion, the evidence and arguments advanced against the 3.5% proposal were not sufficient to show that it was not reasonable within the meaning of the Act.

> [2.] What suggestions were made to the Commission, as indicated in your report, for "more scientifically estimating" contingency allowances in the future? I'm curious why those methods weren't employed in the present.

2. The suggestions included:

(1) A proposal that we find the Postal Service now

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[2] In the proceeding involved in *Newsweek*, the Commission had reduced the contingency to 2.5%.

> . . . has a greater ability to withstand unforeseen adversity . . . than in Docket No. R84-1, where it requested the same 3.5 percent contingency. . . . [The proponent] therefore proposes that we reduce the Test Year before-rates contingency reserve to 2.0 percent, or $761.1 million.

PRC Op. R87-1, para. 2047 (proposal of Readers' Digest Association *et al.*). This proposal relied on the opinion that Postal Service historical variance analysis should be adjusted to remove variances between the assumed and actual rate change implementation dates (set by the Board of Governors) and rate levels -- an adjustment that would have reduced the historical error and thus the implied level of contingency required. We found that both adjusted and unadjusted analyses had their merits; and the 3.5% was well within the range defined by them. PRC Op. R87-1, paras. 2080-2084.

(2) A proposal sponsored by American Bankers Association to reduce the contingency by assuming that forecasting errors are not biased; that each cost-segment forecast has a standard normal distribution and an unbiased standard error; and that the standard error for each segment is independent of all the others, so that they can be summed. These assumptions have not been employed in the past. While a very interesting approach technically, this proposal rests on a very small number of observations considering the size of the differences in overall forecast error with which it deals. PRC Op. R87-1, paras. 2096-2097. In addition, it is not certain that the errors are truly random. *Id.*, para. 2098. These deficiencies are not inherent in the method, which -- with more data, which will become available in the future -- could be much more useful.

(3) An alternative approach used by the New York State

Consumer Protection Board relying on judgments that the Postal Service is in sound financial condition, and that subsequent to the filing of its case the uncertainties surrounding its labor contract had been resolved by the signing of agreements. NYSCPB also argued that if its suggested 2.5% contingency became exhausted, the Service could generate a "de facto contingency" by reinvigorating its cost containment program.

A pervasive feature of the criticisms of the Service's contingency proposal was the judgment -- with which the Commission did not agree -- that the overall financial environment for the Service's test year (FY1989) forecasts "is more stable and predictable than it was in Docket No. R84-1 when the same contingency was recommended." PRC Op. R87-1, para. 2108. This problem involves some elements of business judgment and is not quantifiable in the same way that analysis of forecasting errors might be. Intervenors' attempts at a "more scientific" estimate -- apart from the inherent problems discussed above -- do not fully address this difficulty. In the nature of the case, it is the Postal Service that must explain (for itself and on behalf of the Governors, who concur in the rate request) how and why *its* business judgment suggests a particular percentage level for the overall contingency. In calling for a better articulated and explained presentation (PRC Op. R87-1, para. 2116) we had this problem particularly in mind.

> [3.] Could you set out for us some of the categories of variable cost that the contingency allowance is based on?

3. Estimating the contingency involves analyzing variances between actual and forecast results for all of the cost segments of the Postal Service, as well as its revenues. Thus it is not just variable costs that are relevant (though

they are extremely important); however, all categories of variable cost would be employed. Postal Service Exhibit USPS-14R, which is attached, shows the historical variance analysis for the cost segments which formed part of the basis for the estimated contingency provision.

We should note as well that variance analysis is not the sole basis for estimating the contingency provision; as we stated at para. 2077 of the Docket R87-1 opinion:

> . . . the Commission views the contingency determination as a blending of subjective judgment concerning unknown risks, and objective judgment concerning forecast errors and their sources.

"Unknown risks" cannot be tied to particular cost categories.

> [4.] Are contingency amounts, in your opinion, properly accounted for? For instance, to the extent it is unnecessary for the Postal Service to rely on the contingency in a given year, is this revenue saving carried forward, rather than expended in the current budget?

4. Any meaningful answer must start from the fact that under present law there is no particular requirement governing accounting for contingency amounts. Indeed, so far as the revenue side of the equation is concerned[3], it need not be accounted for at all, qua contingency. Postal Service

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[3] As noted in answer to Question 1, the contingency must be estimated as though it were a *cost* when we recommend rates under §§3621-3624. At this stage, the Commission must "account for" contingency in the sense of explaining why, e.g., 3.5% rather than 2.5% or 4.5% is being recommended. It is in that context that -- as observed in Question 2 -- we urged that better estimation methods be developed. But all this is prospective, and concerns what might be called the contingency in its capacity as a cost item; the present question asks what accounting is given, after the fact, of the *use* of those revenues actually collected as a result of the recommended contingency provision.

revenues are not divided, in the process of accounting for them, between those dollars corresponding to accrued costs and those corresponding to the contingency component built into the rates.

It is possible, though, to conceive of an apparently workable mechanism for an *ex post* accounting for contingency dollars. For example, if they were directed into a separately accounted-for contingency fund[4], both the inflow and the payout of contingency dollars could be monitored.

What has been said above implies that a discrete saving from unused contingency cannot now be firmly identified at the end of a year. (It is of course possible to compare actual cost and revenue levels with the forecasts on which the contingency was earlier estimated.) The lack of an explicit accounting treatment of the contingency does not mean that "unused" contingency dollars are not, in some legitimate sense, carried forward. Since the Postal Service Fund is permanently appropriated, the Service as a whole is not subject to the bureaucratic maxim that if you save money now your reward is a budget cut next year. Mailers can exert moral suasion in favor of delaying the next rate increase proposal -- which may be possible if dollars collected but not needed for contingencies in one year remain available to postpone or minimize operating deficits in subsequent years. (Postmaster General Frank seems to have appreciated quickly

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[4] There is no such fund under current Postal Service accounting policies. If one existed, the estimating process in a rate case might not essentially differ from current practice, but its output would be different. For example, the 3.5% of estimated accrued cost allowed for contingencies would become a distinct annual payment into the fund, rather than an undifferentiated part of total revenue. Arguably, such a changed treatment might reflect better than present practice the statutory (§3621) perception of the contingency as a cost item.

the favor with which many mailers regard this "rate stability" policy.) But while it does not interfere with beneficial uses of leftover contingency dollars, the present system of nondifferentiation also does nothing to promote them.

> [5.] Ms. Steiger, I share your disappointment that the Postal Board of Governors didn't see fit to adopt the "courtesy mail" discount for the average householder. Your Opinion and Recommended Decision this year noted that while household-to-business mail constitutes a significant portion of FIrst Class Mail, householders are the only group of postal customers that doesn't get any cost-based discounts. I wrote to Chairman Griesemer, of the Postal Board of Governors, asking that if they wouldn't hold back the rate increase, the Board at least give priority to a discount for home billpayers.
>
> I am a little curious, though, as to why you Commission didn't recommend anything more forceful than a "shell" increase. If we know, as you say, that the cost savings for each precoded envelope used by consumers is five cents, then why *didn't* you recommend a specific discount? What additional information were you lacking, if any?

5. A majority of the Commission recommended a "shell" classification for courtesy envelope mail ("CEM") -- rather than a new classification with a specific discount rate -- because a number of unknowns remained even after analysis of all the record evidence.

The most -- perhaps the only -- clearly established quantitative fact about CEM was the *per piece* cost differential between it and other nonpresorted First-Class Mail. At 6.5 cents, this per-piece differential would make a five-cent discount a reasonable figure for estimation purposes. PRC Op. R87-1, para. 5059. What was very far from clear on the record, however, was the potential volume of CEM and thus the *overall* change in revenue corresponding to that volume. At a five-cent discount, CEM volume might range

between four and nine billion pieces -- implying a revenue drop of $200 to $450 million. Faced with uncertainties of that magnitude, the Commission found that

> . . . the better approach is to allow the Service to recommend rates in its next omnibus rate proceeding reflecting the substantial cost differences between CEM and other nonpresorted First-Class Mail. Under this approach, the volume of CEM versus other nonpresorted First-Class Mail is not critical because the attributable cost foundation supporting rates for CEM and nonpresorted First-Class Mail will be independently established based on their unique cost levels.

PRC Op. R87-1, para. 5058 (fns. omitted). Attributable costs are a special problem here because when the CEM discount classification is effectuated, CEM's cost will be disaggregated from that of other nonpresorted First-Class Mail -- causing the latter to rise.[5] With so little basis on which to judge the volume of CEM, we could not accurately derive a *total* cost for the remainder of nonpresorted First Class, and hence could not confidently adjust its rates.

> [6.] What reasons did the Board of Governors give for turning down your Courtesy Mail proposal?

6. In their May 2, 1988, decision the Governors said:

> . . . we believe that an examination of worksharing opportunities for the mailers who might benefit from this proposal is worthwhile. . . . we believe there is a serious question of undue discrimination were we to establish a separate rate category on the strength of delivery cost avoidances, while denying that favored rate

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[5] Existing volumes of courtesy return envelopes directed to post office box addresses (and perhaps also bearing some of the markings that facilitate processing) are now averaged in with "run of the mill" FIrst Class collection mail such as hand-addressed letters and greeting cards going to street or rural delivery route addresses. If the lower-cost CEM-type pieces were removed from this cost pool today, the cost of the remainder could be expected to rise significantly.

> treatment to other senders of mail addressed to post office boxes (which occasions the same cost avoidance). We are mindful of the Commission's concern that worksharing rate incentives, now enjoyed by large volume senders, should be available to individuals and low volume business mailers if cost justified. We also agree completely with the notion that a cost-justified worksharing discount for these customers should be accorded a high priority in the Postal Service's efforts to provide services responsive to the needs of the public. We expect postal management to give its attention to ways to implement such a discount, including investigation of revenue loss and enforcement costs. However, given the undue discrimination question that this particular formulation of a worksharing discount presents, we believe we must put aside this recommended change, until it can be more thoroughly explored and refined.

Decision of the Governors of the United States Postal Service on the Recommended Decision of the Postal Rate Commission on Mail Classification Changes, May 2, 1988, at 3-4.

> [7.] Aren't bar-coded Courtesy Envelopes actually easier to machine-read, with less chance for error, than "ZIP + Four" codes? And isn't it more certain that Courtesy Envelopes will be used, since they make return mail easier for the consumer? It strikes me as unusual that the Rate Commission wouldn't press harder for such an option, if there really is a "presumption" in favor of cost-saving innovations. Instead, the Commission added special incentives for "ZIP + Four", which is entirely dependent for its success on user initiative. If it came down to choosing between the two, is "ZIP + Four" really, in your opinion, more worthwhile than Courtesy Mail?

7. In the Commission's view, there is no need to choose between ZIP+4 and CEM. Their purposes differ and they affect mail operations in different ways.

CEM involves the sending of mail by householders, on a single-piece rather than a bulk basis, to a predetermined

business address (which must be a post office box). The savings are generated by markings (Facer Identification Mark or "FIM," ZIP+4 code, barcode, and identification as a CEM envelope) applied by the business sending out the envelopes to consumers, *and* by its choice of a box-section address. ZIP+4, by contrast, involves bulk mailings (which may also be presorted to some degree) to multiple addresses; all the savings are generated by the markings. The incentive to use ZIP+4 flows directly to the business making decisions about the mailing format. In the case of CEM, the business sending out the envelopes is motivated to follow CEM requirements by the fact that its customers will receive a discount when they use the special envelope to reply. While this is certainly a strong motivation, the evidence in Docket R87-1 did not support a firm estimate of how much CEM volume would result.

So far as the comparative treatment of ZIP+4 and CEM in the Docket R87-1 decision is concerned, the Commission actually rejected Postal Service initiatives to make the existing ZIP+4 discount larger. The new incentive the Commission recommended was to extend *eligibility* for a ZIP+4 discount to third-class mail, which up to now has not enjoyed it. This extension simply offers the promise of better utilization of ZIP+4 automated equipment already in place. In both classes, the Commission was careful to relate the discount to actual cost savings.

> [8.] What additional groundwork or action is needed at this time to move the Courtesy Mail proposal forward, and is the Commission taking necessary steps in that direction? Does a specific proposal or request for action have to be pending before the Rate Commission?

8. As noted in answer to Question 5, we do not have the data to estimate adequately the overall volume/revenue effect of CEM. We indicated areas where we would expect the Service

to perform studies (PRC Op. R87-1, para. 5058; and App. K, at 2); of course, input from others is equally desirable.

The Governors have called for further study and refinement of the CEM idea, but have formally rejected the CEM proposal as transmitted in Docket R87-1. Under existing law, all rate and classification changes must result from a formal proceeding before the Commission; hence it is true that "a specific proposal or request" must be before us. In the case of classification changes *not affecting rates*, the Commission may start such a proceeding on its own initiative. Any change recommended in such a proceeding would be a shell classification, similar to that recommended in March and rejected by the Governors in May. Only the Postal Service, on the other hand, may initiate changes in rates. Assuming the Governors decide to pursue the CEM idea, the provision of an actual discount for household users would result from a proceeding initiated by the Service -- either a separate limited rate case to establish a CEM discount and adjust First-Class rates in relation to one another, or a part of the next omnibus rate filing.

REVENUE AND COST VARIANCES
COMPUTATION OF WEIGHTED AVERAGE PERCENTAGE
($ IN MILLIONS)

COST SEGMENT		FY 1983			FY 1984			R-84-1(FY 1985) TEST YEAR			
		ESTIMATED	ACTUAL	PERCENT ACTUAL OVER OR (UNDER)	ESTIMATED	ACTUAL	PERCENT ACTUAL OVER OR (UNDER)	ESTIMATED	ACTUAL	PERCENT ACTUAL OVER OR (UNDER)	WEIGHTED AVERAGE VARIANCE
	REVENUES										
	MAIL & SVCS REVENUE.	23,550.7	23,609.5	0.2	24,555.0	25,347.0	3.2	28,281.1	27,773.3	(1.8)	0.4
	APPROPRIATIONS	789.0	789.0	0.0	717.7	879.0	22.5	863.2	969.6	12.3	11.3
	INVESTMENT INCOME	418.6	390.7	(6.7)	267.0	331.0	24.0	171.0	272.7	59.5	16.1
	TOTAL REVENUES & OPER RECEIPTS	24,758.3	24,789.2	0.1	25,539.7	26,557.0	4.0	29,315.3	29,015.6	(1.0)	0.9
	OPERATING EXPENSES										
1	POSTMASTERS	942.3	934.1	(0.9)	1,020.1	949.8	(6.9)	1,103.1	1,012.5	(8.2)	(5.5)
2	SUPERVISORS	1,645.7	1,654.6	0.5	1,787.2	1,792.3	0.3	1,932.3	1,993.8	3.2	1.4
3	CLERKS & MAILHANDERS	8,193.2	8,213.9	0.3	8,656.0	9,082.5	4.9	8,958.6	9,842.8	9.9	5.2
4	CLERKS CAG K	25.4	31.5	24.3	27.2	29.9	9.8	28.3	29.0	2.4	11.7
6 & 7	CITY CARRIERS	5,469.3	5,484.3	0.3	5,918.1	6,054.8	2.3	6,253.4	6,526.9	4.4	2.4
8	VEHICLE DRIVERS	170.9	171.5	0.4	180.9	186.8	3.3	188.9	204.3	8.2	4.1
9	SPECIAL DELIVERY MESSENGERS	78.7	79.0	0.4	83.8	82.8	(1.2)	85.1	87.7	3.0	0.8
10	RURAL CARRIERS	1,368.3	1,370.0	0.1	1,461.4	1,432.7	(2.0)	1,537.6	1,549.9	0.8	(0.3)
11	BLDG SERV OP ED, BL & ADMIN SU	931.3	931.6	0.0	992.7	1,000.6	0.8	1,053.3	1,060.1	0.7	0.5
12	MOTOR VEHICLE	351.8	352.8	0.3	370.3	372.8	0.7	390.8	390.4	(0.1)	0.3
13	MBU'S MES MISC	97.4	98.7	1.4	101.4	99.6	(1.8)	106.3	111.3	4.7	1.5
14	TRANSPORTATION	1,787.0	1,739.7	(2.6)	1,904.7	1,690.8	(11.2)	2,008.0	2,041.5	1.7	(4.0)
15	BUILDING OCCUPANCY	667.0	663.2	(0.6)	697.7	729.3	4.5	736.3	774.3	5.2	3.1
16	SUPPLIES & SERVICES	621.4	602.0	(3.1)	662.0	674.6	1.9	697.6	796.9	14.2	4.7
17	RESEARCH & DEVELOPMENT	29.2	24.4	(16.7)	28.8	14.7	(49.2)	31.0	13.7	(55.8)	(40.8)
18	ADMIN. & REGIONAL OPERATIONS	1,474.9	1,480.3	0.4	2,026.0	1,872.7	(7.6)	2,508.4	2,407.4	(4.0)	(4.1)
19	SUPPORT SERVICES	12.2	12.5	2.3	13.2	14.0	6.1	13.8	15.3	11.1	6.7
20	DEPRECIATION & SERV WIDE COSTS	343.6	328.9	(4.3)	399.2	359.1	(10.0)	435.8	409.0	(6.1)	(6.9)
	TOTAL ACCRUED COSTS	24,209.6	24,172.9	(0.2)	26,330.8	26,439.6	0.4	28,068.6	29,267.0	4.3	1.6
	CONTINGENCY							982.4			
	RECOVERY OF PRIOR YEAR LOSSES.							288.3			
	TOTAL REVENUE REQUIREMENT	24,209.6	24,172.9	(0.2)	26,330.8	26,439.6	0.4	29,339.3	29,267.0	(0.2)	0.0

NOTE: COLUMN TOTALS MAY NOT ADD DUE TO ROUNDING.
1/ VARIANCE COMPARISON: ACTUAL OVER OR UNDER ( ) ESTIMATE

USPS-14R
Page 1 of 2

HISTORICAL WEIGHTED AVERAGE PERCENTAGE REVENUE AND COST VARIANCES FOR TEST YEARS
(millions)

Cost Segment	R76-1* Estimated	R76-1* Actual	R76-1* % Over Under (-)	R77-1* Estimated	R77-1* Actual	R77-1* % Over Under (-)	R80-1** Estimated	R80-1** Actual	R80-1** % Over Under (-)	R84-1*** Estimated	R84-1*** Actual	R84-1*** % Over Under (-)	Four Year Totals Estimated	Four Year Totals Actual	Four Year Totals % Over Under (-)
Total Revenues	13,027.0	12,914.0	-0.9	14,972.0	14,825.0	-1.0	22,958.6	22,593.9	-1.6	29,315.3	29,015.6	-1.0	80,272.9	79,348.5	-1.2
1	587.7	595.6	1.3	595.1	561.2	-5.7	764.4	810.2	6.0	1,103.1	1,012.5	-8.2	3,050.3	2,979.5	-2.3
2	904.9	955.3	5.6	937.7	958.3	2.2	1,338.9	1,461.0	9.1	1,932.3	1,993.8	3.2	5,113.8	5,368.4	5.0
3 & 5	4,632.5	4,799.9	3.6	5,103.3	5,184.9	1.6	7,026.1	7,361.9	4.8	8,958.6	9,842.8	9.9	25,720.5	27,189.5	5.7
4	55.6	36.8	-33.8	39.6	51.5	30.1	76.7	26.7	-65.2	28.3	29.0	2.5	200.2	144.0	-28.1
6 & 7	3,054.1	3,051.9	-0.1	3,249.0	3,279.3	0.9	4,537.3	4,855.6	7.0	6,253.4	6,526.9	4.4	17,093.8	17,713.7	3.6
8	107.5	108.6	1.0	116.7	118.2	1.3	155.0	155.4	0.3	188.9	204.3	8.2	568.1	586.5	3.2
9	68.9	69.5	0.9	63.6	64.6	1.6	74.2	73.2	-1.3	85.1	87.7	3.1	291.8	295.0	1.1
10	765.7	807.9	5.5	864.9	864.1	-0.1	1,278.5	1,246.0	-2.5	1,537.6	1,549.9	0.8	4,446.7	4,467.9	0.5
11	496.8	481.4	-3.1	499.3	508.6	1.9	720.0	791.3	9.9	1,053.3	1,060.1	0.6	2,769.4	2,841.4	2.6
12	202.3	193.0	-4.6	204.6	203.6	-0.5	316.3	341.1	7.8	390.8	390.5	-0.1	1,114.0	1,128.2	1.3
13	53.0	50.3	-5.1	53.4	49.0	-8.2	70.4	84.1	19.5	106.3	111.3	4.7	283.1	294.7	4.1
14	798.4	786.7	-1.5	956.7	969.6	1.3	1,719.1	1,683.9	-2.0	2,008.0	2,041.5	1.7	5,482.2	5,481.7	.0
15	415.9	375.8	-9.6	473.5	421.7	-10.9	591.5	569.6	-3.7	736.3	774.3	5.2	2,217.2	2,141.4	-3.4
16	254.5	243.9	-4.2	262.5	216.8	-17.4	346.0	423.3	22.3	697.6	796.9	14.2	1,560.6	1,680.9	7.7
17	28.2	17.7	-37.2	19.8	13.7	-30.8	43.3	26.8	-38.1	31.0	13.7	-55.8	122.3	71.9	-41.2
18 & 19	938.7	1,271.1	35.4	1,446.1	1,741.8	20.4	2,441.9	2,230.5	-8.7	2,522.2	2,422.7	-3.9	7,348.9	7,666.1	4.3
20	221.1	245.0	10.8	289.4	306.3	5.8	358.5	280.8	-21.7	435.8	409.1	-6.1	1,304.8	1,241.2	-4.9
Total Accrued Costs	13,585.8	14,090.4	3.7	15,175.2	15,513.2	2.2	21,858.1	22,421.4	2.6	29,068.6	29,767.0	4.3	78,487.7	81,292.0	3.3

* From Table 1, pg. 36, Vol. I of Opinion and Recommended Decision, Docket No. R77-1.
** From Exhibit USPS-18R, Direct Testimony of J. K. Lee, Sr., Docket No. R84-1.
*** From Exhibit USPS-18A, Direct Testimony of J. K. Lee, Sr., Docket No. R84-1.

POSTAL RATE COMMISSION
Washington, D.C. 20268-0001

September 2, 1988

The Honorable David H. Pryor
Chairman, Subcommittee on Federal Services,
Post Office and Civil Service
Committee on Governmental Affairs
United States Senate
Washington, DC 20510-6250

Dear Senator Pryor:

During my May 16th appearance before your Subcommittee, you asked if the Commission could determine how OPM arrived at its estimate of the Postal Service payments required to fully fund retirement Cost-of-Living Adjustments for Postal annuitants.

The enclosed document responds to that request. As you will note, we discussed the issue with the people at OPM and were provided with their July 20th response to you on this subject. We have raised several questions with OPM regarding their confidence in a few of the underlying assumptions. Our concerns focus upon the implicit assumption by OPM that the characteristics of Postal retirees which affect annuity costs are similar to and will change in proportion with those same characteristics of all Government retirees. The trend in Postal wage increases since reorganization is one of several factors we identify which could result in the OPM estimates being incorrect. Length of service and age at retirement are two other characteristics which may be different for Postal retirees than all other Government retirees. The annual cost to the Postal Service for their annuitant cost-of-living adjustments estimated by OPM were developed with the assumption of similarity between Postal retirees and all Government retirees. If these assumptions are found invalid, the estimates will, of course, need to be revised. OPM is continuing to explore the available information on this subject and has promised to advise us of their findings.

We shall be glad to respond to any questions you may have regarding the enclosed document.

Sincerely,

Janet D. Steiger

Enclosure

cc: Constance Horner

September 1, 1988

STAFF ANALYSIS OF
THE OPM RECOMMENDATION
THAT USPS FULLY FUND COLA PAYMENTS
FOR POSTAL ANNUITANTS

Senator Pryor was seeking Postal Rate Commission assistance in identifying the supporting documentation to budget estimates which indicated that fully funding retiree COLAs would cost the Postal Service an additional $662 million for FY 1990, $645 million for FY 1991, $836 million for FY 1992, and $1 billion in FY 1993.

In attempting to respond to Senator Pryor's request to Chairman Steiger at the May 16th Commission appearance before the Subcommittee on Federal Services, Post Office and Civil Service, Senate Committee on Governmental Affairs, we have had several conversations with the people at OPM.

These conversations, supplemented with a letter to Senator Pryor from OPM, have provided a decent overview of how OPM developed the cost estimates supporting its proposal to implement recommendations contained in the President's Budget for FY 1989 regarding the Postal Service paying the full cost of providing Cost-of-Living Adjustments (COLA) to Postal Service annuitants.

SPECIFIC PROCEDURES

The first step in the process was to determine that, as of September 30, 1987, the monthly annuity payments to annuitants who last worked for the Postal Service accounted for 20 percent of all Government annuity payments.

The second step in the process was to estimate the annual value of FY 1989 COLA payments to all employee and survivor annuitants using the 4.2 percent COLA estimate contained in the Budget and the actuarial data for projecting annuity payments for all of Government from September 1987 to FY 1989.

The third step is to take 20 percent of the FY 1989 COLA payment calculated for all of Government and assume that that amount is the share of total COLA for FY 1989 that is attributable to the Postal Service. The Government wide COLA expense for annuitants for FY 1989 is estimated to be $1.092 billion, of which $218.4 million (20 percent) was the responsibility of the USPS.

The fourth step is to determine the present value of the $218.4 million COLA paid to annuitants in 1989, which will also have to be paid each year of the current annuitants' lives, plus the portion which will continue to be paid each year to their eligible survivors for the balance of their lives or eligibility period. This step will determine the amount of money the Government will have to set aside now, assuming the fund's 5 percent interest rate[1] and related assumptions, to provide for the liability resulting from this single FY 1989 COLA. The actuaries have determined that 10.78 times the $218.4 million will provide these funds, or that the present value of the Service's share of the COLA liability for FY 1989 is $2.355 billion ($218.4 million times 10.78).

The final step in the process is to determine how much the Postal Service should pay each year over how long a period to reimburse (fully fund) the Federal Government for this liability. The recommended time period for paying this money to the Government is fifteen years. This approaches the time period over which the annuitants are expected to live and therefore collect these COLA payments. The calculation for this step is very much like determining equal annual mortgage payments over fifteen years, which will cover the total $2.355 billion present liability value, plus interest each year on the remaining balance. The value of this calculation amounts to $2.355 billion divided by 10.9[2], or $216.1 million per year for the fifteen years (1989 to 2003).

A similar set of calculations is necessary for each year, i.e. FY 1990, FY 1991, etc., always beginning with an estimate of the annual annuity for each year and then the individual COLA for that year. The Postal Service share for that year is then calculated. Then, again, the present value is calculated for that year's liability, and finally, the fifteen annual payments for that liability are calculated. The total payment to be made by the Service to the Government to fully fund annuitants COLAs is then the sum of the annual payments owed for each year's COLA over the fifteen year period. This would be summed so 1990 would require a cash payment for one of the fifteen 1989 payments, plus one of the fifteen 1990 payments. In 1991, the sum of three payments would be required, the 1989, 1990 and 1991 payments. This pattern would continue. There is, however, one variation from the above described

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[1] This rate of 5% is statutorily mandated for use in static calculations for the Fund.

[2] This factor (10.9) results from calculating the fifteen equal annual payments to fund the liability when an interest rate of 5% is used.

pattern. The bipartisan Budget Agreement for 1989 had already been set, spelling out specific transactions. To accommodate that Agreement, the Postal Service payment for 1989 is deferred to 1990. Thus, in 1990 the Service will pay the first of the fifteen 1989 payments plus interest to 1990, the second 1989 payment, and the first of the fifteen 1990 payments.

CONCERNS

In evaluating the above described method followed by OPM for estimating the Postal Service share of COLA payments, several assumptions appear to be potentially in error. We have discussed these concerns with OPM personnel and they agree that these items could be in error. They plan to explore these questions over the next year and will notify us of their findings. We shall describe these concerns below.

The first concern revolves about the assumption that 20 percent of total Government annuity payments, found to be the proportion attributable to the Postal Service in September of 1987, will remain constant in all future years. This appears to be questionable for several reasons:

a) The "high three" year salary and the number of years of Government service determine the monthly annuity payment for any retiree. It is not clear that wage increases and years of service for Postal retirees will grow at the same rate as for all other Government employees, particularly, since up to now, Postal wage increases have been greater than other Government employee wage increases. A related concern is the implicit assumption that the number of persons who will retire each year from the Service is consistent with the proportion of total Government retirees. OPM advises that the calculation of this percentage of total annuity payments will again be available for September 1988 and might yield some clues as to the reliability of the constant 20 percent assumption. They do plan to do some other work in the future to estimate what will happen in later years.

b) Is the number of years of Government service at retirement the same for Postal employees as for all Government employees, and is it likely to remain proportionately in line with all of Government? If not, even if the "high three" were the same as for the others, the relative percentage of the high three, which determines the annuity, would be different than that of other Government employees, and the 20 percent of all annuitant payments could be significantly different.

This would change the Service's annual payment dramatically. We plan to follow up with OPM toward the end of the year when at least the 1988 proportions will be available.

c) Is the proportion of Postal retirees who elected the FERS program consistent with all of Government? If it is not, over time this too will affect the 20 percent assumption.

The second concern regards the life expectancy issue. Is the life expectancy, at retirement, the same for Postal workers as for other Government employees, and are their survivors likely to have the same life expectancy as all other Government employee survivors? This question was addressed by actuaries some time ago and the finding, we are told, was that the life expectancies were similar -- whatever that means.

The third concern is whether the fifteen year amortization period selected, over which the liability for any year's COLA payment will be paid for in equal annual installments, is reasonably close to the life expectancy of annuitants -- retirees and their survivors? Here again, OPM expects that the actuaries will try to carefully assess this in the next year.

United States General Accounting Office

GAO Testimony

For Release
on Delivery
Expected at
2:00 p.m. EDT
Monday
May 16, 1988

Postal Service Operations

Statement of
L. Nye Stevens, Associate Director
General Government Division

Before the
Subcommittee on Federal Services,
Post Office and Civil Service
Committee on Governmental Affairs
United States Senate

?/T-GGD-88-34

POSTAL SERVICE OPERATIONS

SUMMARY OF STATEMENT BY
L. NYE STEVENS
ASSOCIATE DIRECTOR, GENERAL GOVERNMENT
DIVISION, GENERAL ACCOUNTING OFFICE

In response to numerous requests from congressional committees, GAO has reviewed a variety of Postal Service operations that contribute to postal oversight by Congress.

The Postal Service has taken action in response to GAO recommendations during the past year that addressed the following issues:

--policy implementation and cost savings in the use of cluster boxes for delivery of mail to new residential addresses;

--increasing the use of automated equipment to process ZIP + 4 mail that was given postage discounts but often handled like undiscounted mail;

--accounting for the costs of Postal Service contributions to the non-profit Postal Forum organization that sponsors annual conventions of postal officials, suppliers, and customers; and

--strengthening postal procurement operations, in which GAO's review revealed several recurring weaknesses in procurements of $1 million or more despite the general application of acceptable internal controls.

GAO is currently evaluating compliance with the capital and operating budget reductions mandated by the Budget Reconciliation Act of 1987. In addition, GAO is analyzing the postal headquarters operating budget for possible reduction opportunities, since all reductions for fiscal year 1988 were levied on field offices. The Postal Service considered and rejected a number of alternative budget cuts in devising its plan, such as closing smaller post offices and air terminal hubs, consolidating processing operations, and changing its policy on delivery to the customer's door.

Other work GAO is currently doing at congressional request includes reviews of real estate, personnel, optical character reader procurement, and contingency planning.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to contribute to your oversight of the Postal Service. The past few years have been, for the Postal Service, a time of change and challenge, that continues today. There has been an intensified effort by some to "privatize" the postal function. Restrictions have been placed on the operating and capital budgets for fiscal years 1988 and 1989. There have been widespread complaints from postal customers who had just experienced a curtailment of services while paying more for postage, and from local communities abruptly seeing postponement of plans for construction of a new post office. There have been four Postmaster Generals since 1985.

All of these things have occurred within an environment that has seen the volume of mail increase, the number of employees increase, and the cost of processing the mail increase. Yet, the goal of the Postal Service should remain the same--to assure that the customers get the best possible service. Dealing with all of these issues will be a challenge that will require continued cooperation between management and labor to address the issues effectively so that quality service can be provided at a reasonable price.

Before discussing the manner in which the budget reduction requirements were implemented and the work that we are doing to

report on compliance, I would like to make you aware of the range of our postal work and summarize some recent reports issued to committees of Congress.

GAO WORK

For the past several years all of our available staffing resources in the postal area have been applied to responding to specific congressional requests. Our on-going congressional request assignments deal with a variety of subjects. We are working on acquisition of land for post offices, employee discipline, treatment of employees injured on duty, screening of applicants for postal employment, management of employees during their probationary period, procurement of the multiline optical character readers, mailings by religious organizations, reduction in window service hours in Ohio, and how the Postal Service dealt with the Edmond, Oklahoma, tragedy. In addition, we recently began the compliance evaluation required by the Budget Reconciliation Act, and related work on the headquarters budget as agreed with your staff. Before commenting more on this work I would like to briefly summarize some recent reports we have issued.

Cluster Mailbox Delivery

In June 1987 and February 1988, we reported on the use of cluster mail boxes for new residential addresses. Cluster boxes are pedestal-mounted units which are located outdoors and are used to consolidate mail delivery at a single point for either 8, 12, or 16 houses. Each house served by a cluster box is required to pick up mail from its own separate, locked compartment.

In June 1987 we reported on compliance with Postal Service policy which stipulates that cluster mailbox delivery is to be offered as one of three mail delivery options available to new housing areas. Mail delivery to curbside boxes or to mailboxes located behind the sidewalk are the other two options that should be offered to the developer who, for new addresses, is considered by the Postal Service to be the postal "customer."

We found that the Postal Service was not consistently adhering to its policy of offering a choice between cluster boxes and other delivery options. The Postal Service agreed to check adherence to its policy periodically, and to revise a standard consent document to clearly disclose to developers the availability of two delivery options in addition to cluster boxes.

Our second report on cluster boxes provided comparative cost data for mail delivery to residential addresses. We confirmed that

the use of cluster boxes reduces mail delivery costs for residential customers living in detached homes and townhouses. The savings amount to about $10 annually for each address.

Processing of ZIP + 4 Letters

In 1983, the Service implemented the ZIP + 4 program to reduce the cost of processing First-Class letters and cards. The program features a 9-digit Zip Code, which businesses are encouraged to use, and automated equipment--optical character readers and bar code readers. With the automated equipment, letters addressed with the ZIP + 4 code can be automatically sorted to carrier routes and the resultant savings are shared with mailers by providing a postage discount of 0.5 cent or 0.9 cent per letter.

In October 1987, we reported that, over an 18-month period, the Postal Service provided about $25 million in postage discounts on ZIP + 4 mail that was not automatically sorted to carrier routes. Many letters were not processed automatically because the mail processing centers which did the sorting were not automated. At automated centers, reasons for not automatically sorting ZIP + 4 mail to carrier routes included not having procedures in place to capture all of the mail that could be automated and optical character readers rejecting letters as unreadable.

Field operations managers have been told to monitor the volumes of ZIP + 4 mail available for automated processing. Other improvements promised by the Postmaster General include the training of more automation readability specialists to improve the machine readability of mail and evaluating the accuracy of ZIP + 4 codes mailers and vendors are assigning to address lists.

Postal Forums

In September 1987, we reported on the relationship between the Postal Service and the National Postal Forum - a non profit organization that sponsors annual conventions for postal officials, suppliers, and customers. We reported that the Postal Reorganization Act of 1970 contains authorities sufficiently broad to allow the Postal Service to make financial contributions to organizations such as the National Postal Forum. We found, however, that the Service did not prepare a budget for total annual forum expenditures or record amounts spent as forum costs. In response, the Service agreed to establish systematic accumulation methods for forum expenses and to properly record them.

Procurement

Last week we reported on the Postal Service's procurement function which is one of the largest in the federal government.

The Service annually purchases goods and services valued at about $4 billion. We found that several accepted controls to help deter fraud and assure that the Service was getting its money's worth were routinely applied to contracts. Despite the application of acceptable internal controls, we identified five recurring weaknesses in postal procurement practices and determined that 44 of the 109 large dollar contracts ($1 million or more) we examined had one or more of these weaknesses. Correcting these weaknesses would improve contracting practices and result in dollar savings. The Postal Service accepted our findings and said corrective actions have been taken or are underway in response to our recommendations.

BUDGET REDUCTIONS

Let me turn now to a matter that has received considerable attention -- the effect of the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203) on the Postal Service. As you know, for the first time since postal reorganization in 1970, last December's Budget Reconciliation Act imposed mandatory restrictions on the capital and operating budgets of the Postal Service for fiscal years 1988 and 1989.

Capital Budget

Capital investment commitments were restricted to $625 million in fiscal year 1988 and $1,995 million in fiscal year 1989. Restricting commitments at these levels lowered planned commitments by $1.7 billion (73 percent) in 1988 and $635 million (24 percent) in 1989. To lower 1988 commitments to the required level the Service made across-the-board reductions with the greatest impact on facilities where planned commitments were reduced 79 percent, from $1.7 billion to $356 million.

Operating Budget

The required reductions in the operating budget were $160 million in fiscal year 1988 and $270 million in 1989. Plans showing how the Service intends to achieve the required savings must be submitted to Congress and we are required to report to Congress on the Service's compliance with those plans.

We are now reviewing the implementation of the 1988 plan. I will explain how the plan was developed, the budget items that the Postal Service selected to reduce and the amounts, and some items that it did not choose to reduce.

The 1988 spending reduction plan was prepared by a working group under the direction of the Senior Assistant Postmaster General

for Operations. Teams were formed to identify and set priorities for potential actions which would produce the desired savings. Through a series of meetings involving headquarters and field personnel, various alternatives were discussed, modified and adopted or rejected. The Service had to take into account that by the time the Act passed, the fiscal year was nearly one-fourth over. Thus, the working group emphasized prospective changes that could be quickly implemented and would produce immediate savings. The 1988 plan, submitted to Congress in February, is attached to my statement. The dollar amounts for the 10 cost reduction actions are Postal Service estimates that were not included in the submitted plan. As shown, anticipated savings from the planned actions total $173.8 million - a buffer of $13.8 million above the required amount. Over $100 million of the anticipated savings are expected to come from two of the actions--reductions in such administrative costs as training and travel, and in window service hours. Also, all of the reductions were levied on budgets of the Service's field offices. The Headquarters 1988 administrative budget, $1.0 billion, an increase of 7 percent over 1987, was not reduced. As agreed with your staff, we are currently analyzing this budget.

COST REDUCTION ACTIONS CONSIDERED AND REJECTED

The Postal Service considered many other cost savings measures before adopting those listed in the plan. Some of these

alternatives are under consideration for possible implementation in fiscal year 1989, when the operating budget has to be reduced $270 million. In general, the Postal Service rejected these changes in fiscal year 1988 because they would not produce enough verifiable savings, would take too long to implement, would be counter to service improvements that the Postal Service had achieved, or would be too unpopular. Options considered in the latter group included closing small post offices, switching from door to curb delivery, and centralizing all new deliveries to cluster boxes. Options that were not adopted because they were counter to service improvements included closing air terminal hubs in Nevada and Indiana, and merging mail of different classes into a single stream at certain processing points. Another proposed change involved holding some letter mail an extra day at processing points to maximize the use of available automated equipment. While the Postal Service estimated this could save $130 million in 1988, it considered the effect on mail service to be a major drawback. However, the Service is still considering the proposal for 1989.

In the personnel area the Service considered offering early retirement and increasing the use of temporary, or casual, personnel. The possible savings from early retirements were not considered large enough compared to the potential disruption from the loss of the Service's most skilled employees. The Service also saw as a disadvantage the requirement that it would have to

offer early retirements across-the-board and would not be able to target them where it believed they would be most cost-effective.

Greater use of casual employees would save money because they are paid less than permanent employees and they receive no benefits. While the maximum number of casual employees is generally limited by collective bargaining agreements to five percent of the workforce, the Postal Service is presently below this ceiling. Service officials considered what would be necessary to maximize the use of casuals as a cost reduction measure, and concluded that at this time casual utilization was at its highest practical level.

In line with the Reconciliation Act requirement that we determine if the Postal Service carried out its cost reduction responsibilities, we are currently looking at how the various reduction actions can be best documented and measured.

That concludes my prepared statement, Mr. Chairman. My colleagues and I would be pleased to answer any questions you may have.

ATTACHMENT ATTACHMENT

IMPLEMENTATION PLAN

FISCAL YEAR 1988

OPERATING BUDGET REDUCTIONS

PUBLIC LAW 100-203

United States Postal Service
Washington, D.C.

ATTACHMENT ATTACHMENT

IMPLEMENTATION PLAN
FISCAL YEAR 1988
OPERATING BUDGET REDUCTIONS
PUBLIC LAW 100-203

($ Millions)

1) Initiate Servicewide Administrative Cost Reduction Program $67.1

Institute significant reductions in administrative personnel costs, travel, training and supplies and services budgets. Activities affected by personnel cost reductions are finance, human resources, marketing, and general administrative. This action does not impact Postmasters. These costs generally support postal operations but do not directly involve the processing and delivery of mail.

2) Reduce and Centralize the Innovation Fund $7.4

The purpose of the innovation fund is to encourage research and development projects in the field at a no cost/no risk condition to field operating budgets. These funds have been reduced. However, limited funds are still available to encourage projects.

3) Carrier Route Information System Sortation $13.6

We intend to implement nationally a locally researched and developed effort that increases the sorting capability of our single-line optical character readers. The Carrier Route Information Sortation System requires minimal investment and will pay for itself almost immediately.

ATTACHMENT ATTACHMENT

IMPLEMENTATION PLAN
FISCAL YEAR 1988
OPERATING BUDGET REDUCTIONS
PUBLIC LAW 100-203

($ Millions)

4) Convert Some Air Transportation to Highway Transportation $10.0

Conversion to cheaper highway transportation will reduce overall transportation costs. This action is expected to result in minimal service impact but will involve a significant reduction in operating flexibility and some potential risk due to longer ground transport times.

5) Eliminate Selected AMTRAK Service $2.0

Contracts for dedicated space on AMTRAK trains will be terminated and mail will be diverted to more fully utilize existing ground transportation. No service deterioration is anticipated.

6) Increase Load Requirements for BMC Rail/Highway Vans Transportation $11.2

Bulk mail center rail and highway van dispatch procedures will be revised to encourage increased van utilization. BMC vans are currently dispatched according to specific schedules linked to service expectations regardless of whether they are loaded to capacity. Some vans will now be delayed for dispatch until they are full, but will not be held beyond an additional 24 hours. Some deterioration in Bulk Business Mail Service is anticipated.

ATTACHMENT ATTACHMENT

IMPLEMENTATION PLAN
FISCAL YEAR 1988
OPERATING BUDGET REDUCTIONS
PUBLIC LAW 100-203

($ Millions)

7) **Eliminate ZIP+4 Look-Up Service Provided Through Computer Forwarding Sites** $2.0

Suspend ZIP+4 look-up service associated with change of address requests processed by computer forwarding sites.

8) **Elimination of Outgoing Distribution on Sundays** $18.0

Eliminate outgoing distribution on Sunday. This action essentially eliminates the collection and processing of outgoing mail on Sunday. This action would not affect Express Mail, drop-ship arrangements, and some platform operations.

9) **Close Selected Retail Operations and Reduce Collections** $2.5

Service reductions were implemented the days following Christmas and New Years.

10) **Reduction in Window Service Hours** $40.0

Reduce window service hours up to 10%. This roughly equates to all offices losing about 1/2 day's service per week. The field has been instructed to accomplish this reduction while considering local service needs. While minimized, some inconvenience to the public will occur.

TOTAL $173.8

Questions Submitted by Senator Jim Sasser

Question

According to the Postal Rate Commission, the allowance for contingencies, or "cushion" if you will, built into the Postal Service's recent rate increase request amounted to as much as a third of the increase, even though the rate commission expressed concern that the availability of this cushion might undercut efficient management.

Has your office reviewed the size and appropriateness of the contingency allowance under present budget conditions?

Answer

No, we have not reviewed the contingency allowance, although we note that the amount, about 3.5 percent of total costs, is consistent with amounts allowed by the Postal Rate Commission in prior rate cases.

Question

Do you have an opinion whether the contingency calculation process could be improved? Should less of a contingency be allowed?

Answer

We have no basis for saying that the contingency should be handled differently or reduced.

Question

What procedures exist for monitoring offsets against the "contingency" set-aside? That is, does the system presently monitor whether these monies are required for emergencies, and if not, are we sure that these revenue savings are realized, that the money doesn't just get spent on some other part of the Postal Service?

Answer

There are no such procedures. The portion of postal revenue that is produced by including the contingency in the cost base becomes part of overall revenues. There is no segregation of revenue and no accounting for costs intended to be covered by the contingency.

Question

Does GAO have any position, or opinion to express on the advisability of taking the U.S. Postal Service out of the federal budget?

Answer

GAO has traditionally favored maintaining a comprehensive budget. At the same time, we are increasingly concerned about certain deficiencies in the current unified budget structure that create special problems for entities such as the Postal Service. The federal budget now makes no systematic distinction between capital investments and operating expenses. This is a serious weakness which can lead to unsound deficit control strategies and to a budget bias against capital programs. We believe that the Postal Service budget issue should be addressed through a general restructuring of the budget that would replace the current budget presentation with a new four-part structure. The new structure would distinguish between operating expenses and capital investments, and trust and non-trust fund activities. The Comptroller General testified on more detail on this concept before the Senate Governmental Affairs Committee on June 7, 1988.

Question

Can you gives us your evaluation of the Postal Service's budget process as it relates to service hours? Specifically:

-- was due consideration given to alternative methods of reducing operating costs?
-- have window hours been coordinated or implemented in the least disruptive manner? For instance, if you are in a position to give an opinion, have window closings been staggered among neighboring post offices, to permit postal customers an alternative if the nearest office is closed?

Answer

When Postal Service officials prepared the budget reduction plan, they considered many options besides the ten particular initiatives in the final plan. Some of these, along with the reasons they were not adopted were mentioned in our testimony. It would appear that the reduction in window service was chosen over some of the other options because it could be implemented quickly, was certain of producing savings, and was not as harsh or permanent as some other actions, for example closing some post offices or installing more cluster boxes.

Guidance that went to the field from the Deputy Postmaster General stated that the corporate goal was to reduce hours based on customer need, not operational convenience. The guidance included several instructions on ways to minimize disruption to

the public including staggered hours, surveying customers and evaluating lobby traffic to identify when to reduce hours, publicizing the new hours, and making vending services more available. We have not done any work directed expressly at the success of these techniques, however from our current work on the budget reductions, it does appear that staggered window hours have been a common method for attempting to minimize the effect of reduced window hours.

Questions Submitted by Senator Lawton Chiles

Question

As you know, the reconciliation bill last year contained a provision requiring GAO to audit and verify savings made by the Postal Service in its operational budget. Could you describe for me your activities in that area and whether GAO will be able to independently verify to the Congress that, in fact, the mandated savings have been achieved? Given the fact that the cuts are so small in relation to the overall size of the budget, what percentage margin of error would you expect in such an audit?

Answer

Our review uses the following approach to conclude whether the Postal Service has complied with the mandated savings reductions: (1) assessing the reasonableness of the estimates attached to the 10 cost savings measures specified by the Postal Service, (2) verifying that the operating budget was reduced by the estimated amounts, (3) verifying through selective on-site visits that the measures have been carried out, and (4) examining records to determine if the Service comes in at or below its reduced budgets.

A normal margin of error would exceed the size of the cost reduction. For example, the reduction of $160 million was about .4 of one percent of the 1988 operating budget of about $36 billion. If operating costs after the reduction were to be $35.840 billion and were verified through standard statistical sampling techniques using a 3 percent margin of error, the range of probable costs would extend from $34.8 to $36.9 billion.

Question

The Postmaster General is now indicating that window hours may possibly be restored in July, three months earlier than anticipated. You have indicated to my staff that this may come about due to unanticipated savings due to less than expected cost of living increases. Could you explain this in a little more detail and indicate how much these savings might be?

Answer

Career postal employees receive wage and salary cost-of-living-allowance (COLA) increases of one cent an hour for each .4 of a point increase in the Consumer Price Index, payable each May and November (based on CPI increases reported for March and September).

In preparing its annual budget plan, the Postal Service must estimate the COLA increases that will occur during the year. Actual COLAs during the year that are lower than estimated

represent a savings from planned costs, and higher COLAs are an extra cost over and above the plan.

The Postal Service, using a contractor for economic forecasting, estimated that the May 1988 COLA increase would be 15 cents per hour. It was actually 10 cents per hour. From May 7, 1988, when the COLA became payable, until the end of the fiscal year the Service planned to incur about 622.8 million paid hours by career employees. At a differential of 5 cents an hour, the total estimated savings amounts to about $31.1 million.

Question

It appears that it is very hard to tell where the Postal Service's budget will be day to day. Are there any other back pocket savings like the COLA windfall that we can come up with to restore all the other cuts the Postal Service has made?

Answer

We aren't aware of other unanticipated savings of the magnitude of the COLA windfall at this time, however their possibility shouldn't be ruled out.

Question

You've testified that the Postal Service's headquarters budget of over $1 billion was not touched. If you added in the regional administrative budgets to the headquarter's budget, you would have somewhere in the range of $3 to $6 billion in administrative expenses not directly related to delivering the mail. The percentage across the board cut against that part of the budget would be somewhere between two and one half to five percent, is that not correct?

Answer

Regional costs for personnel not directly involved in mail operations plus non-personnel costs of travel and training totaled about $2.7 billion in the 1988 budget, prior to the reduction. This added to the headquarters budget equals about $3.7 billion, of which the $160 million reduction would be about 4.3 percent.

Question

As part of the letter request you received from Senators Glenn, Pryor, and myself, we asked GAO to see if they could identify any construction projects which were permanently cancelled due specifically to the congressionally imposed limits on capital spending. Since there seemed to be some confusion in press

accounts and from the Postal Service earlier this year, could you please report what you've found in this area?

Answer

Because of the limits on capital spending, the Postal Service has delayed many constructions projects, but has not permanently cancelled any.

Question

In your testimony, you indicate that it is a challenge for the Postal Service to maintain the goal of the best possible service while dealing with a changing environment. Specifically, you say that this challenge will require "continued cooperation between management and labor". What do you mean by this statement, and how can GAO contribute to meeting this challenge?

Answer

Because pay and benefits are such large costs to the Service, about 83 percent of the budget, cooperation between management and labor in keeping personnel costs down is vital and will certainly remain a major challenge into the future.

To the extent that we have staff resources available after satisfying our Congressionally requested assignments, we would like to do some self-initiated work in the area of labor costs.

UNITED STATES
OFFICE OF PERSONNEL MANAGEMENT
WASHINGTON D.C. 20415

Office of the Director

MAY 13 1988

Honorable George Bush
President of the Senate
Washington, D.C. 20510

Dear Mr. President:

The Office of Personnel Management submits herewith a legislative proposal, "To amend title 5, United States Code, to require the District of Columbia government and the United States Postal Service to fund retirement cost-of-living adjustments for their respective annuitants, and for other purposes." This proposal would implement recommendations contained in the President's budget for fiscal year 1989. We request that you refer this proposal to the appropriate committee for early consideration.

In financing benefits under the Civil Service Retirement (CSR) System, the rates at which employing agencies currently contribute to the CSR System generally parallel the rates paid by employees. Given the relatively generous features such as the full and automatic adjustment of benefits to offset increases in the cost of living as reflected by changes in the Consumer Price Index, the combination of employee and agency contributions is inadequate to fully finance all CSR benefits. Necessary additional funding is provided from general revenues in the Treasury of the United States. This is true even for entities expected to be financially self-sufficient, such as the United States Postal Service and the government of the District of Columbia.

This proposal would reduce these substantial, hidden Federal subsidies by requiring the Postal Service and D.C. government to contribute additional money to the Civil Service Retirement and Disability Fund to cover the full cost of providing cost-of-living adjustments for annuities of retirees and of survivors of active or retired employees of both entities. The Postal Service is already required to make payments to the Fund, amortized over 30 years, for increases in the Fund's unfunded liability attributable to Postal Service pay increases. This bill would create comparable procedures to fund the liability attributable to cost-of-living adjustments for annuitants of the Postal Service and the D.C. government. The principal difference is the use of a 15-year amortization period in the new provisions. The shorter period reflects the more immediate impact on the Fund of annuity adjustments as opposed to the delayed effect of incorporating higher pay rates for still-active workers.

These proposed changes are consistent with the Bipartisan Budget Agreement reached last fall. While these changes will take effect in fiscal year 1989, the initial payment by the Postal Service will be deferred until fiscal year 1990, with that first payment covering both fiscal years.

We estimate that the increased receipts from the government of the District of Columbia would reduce the budget deficit by the following amounts:

Fiscal Year 1989	$ 7.1 million
Fiscal Year 1990	14.4 million
Fiscal Year 1991	21.3 million
Fiscal Year 1992	27.6 million
Fiscal Year 1993	33.2 million
1989-93 total	$103.6 million

Increased payments by the Postal Service to the Civil Service Retirement and Disability Fund would be as follows:

Fiscal Year 1990*	$ 662.4 million
Fiscal Year 1991	645.3 million
Fiscal Year 1992	836.7 million
Fiscal Year 1993	1,006.2 million
1990-93 total	$3,150.6 million

*Includes payment for fiscal year 1989.

These payments by the Postal Service constitute intragovernmental transfers and, as such, will not affect the budget deficit. They will, however, charge the costs involved to the appropriate account.

The Office of Management and Budget advises that enactment of this proposal would be in accord with the program of the President.

A similar letter is being sent to the Speaker of the House of Representatives.

Sincerely,

Constance Horner

Constance Horner
Director

Enclosures

A BILL

To amend title 5, United States Code, to require the District of Columbia government and the United States Postal Service to fund retirement cost-of-living adjustments for their respective annuitants, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 8348 of title 5, United States Code, is amended by adding at the end thereof the following new subsection:

"(m)(1) Notwithstanding any other provision of law, the United States Postal Service and the government of the District of Columbia shall each be liable for that portion of any estimated increase in the unfunded liability of the Fund which is attributable to any benefits payable from the Fund to retired employees, and to survivors of active or retired employees, of their respective organizations, when the increase results from a cost-of-living adjustment under section 8340 of this title.

"(2) The estimated increase in the unfunded liability, referred to in paragraph (1) of this subsection, shall be determined by the Office of Personnel Management. The United States Postal Service and government of the District of Columbia shall each pay the respective amounts so determined by the Office in 15 equal annual installments with interest computed at the rate used in the most recent valuation of the

Civil Service Retirement System, with the first payment thereof due at the end of the fiscal year in which a cost-of-living adjustment becomes effective.".

Sec. 2. In computing the payments required from the United States Postal Service under section 8348(m) of title 5, United States Code, as added by section 1 of this Act, the Office of Personnel Management shall include the estimated increase in the unfunded liability of the Civil Service Retirement and Disability Fund which is attributable to benefits payable from the Fund to retired employees of the Post Office Department and to survivors of active or retired employees of that Department, when the increase results from a cost-of-living adjustment under section 8340 of title 5, United States Code.

Sec. 3. (a) Except as provided by subsection (b) of this section, the amendments made by this Act shall take effect on the date of enactment of the Act, and shall apply to each cost-of-living adjustment under section 8340 of title 5, United States Code, that takes effect on or after that date.

(b) Notwithstanding subsection (a) of this section, the first payment by the United States Postal Service to the Civil Service Retirement and Disability Fund required by this Act shall be made in the fiscal year ending September 30, 1990, but shall include an amount sufficient to place the Fund in the position it would have been in had the first payment been made in the preceding fiscal year.

SECTION-BY-SECTION ANALYSIS

To accompany a draft bill

"To amend title 5, United States Code, to require the District of Columbia government and the United States Postal Service to fund retirement cost-of-living adjustments for their respective annuitants, and for other purposes."

The first section amends section 8348 of title 5, United States Code, to require the United States Postal Service and the government of the District of Columbia to finance cost-of-living adjustments paid under the Civil Service Retirement System to their respective annuitants.

The amendment adds a new subsection (m) requiring the United States Postal Service and the government of the District of Columbia each to pay the Civil Service Retirement and Disability Fund for any estimated increase in the unfunded liability of the Fund which is attributable to benefits payable from the Fund to retired employees and survivors of the Postal Service and the District government, when the increase results from a cost-of-living adjustment under section 8340 of title 5, United States Code. The procedures established for computation and payment are similar to those currently used for unfunded liability attributable to Postal Service pay increases, except that the amortization period for the payments would be 15 years rather than 30 years.

Section 2 requires the Office of Personnel Management, in computing the payments to the Civil Service Retirement and Disability Fund required from the United States Postal Service because of cost-of-living adjustments under section 8340 of title 5, United States Code, to include any increase in unfunded liability resulting from such adjustments in benefits payable to retired employees of the Post Office Department, the predecessor of the Postal Service, and the survivors of active or retired employees of the Department.

Section 3 provides in subsection (a) that, except as provided in subsection (b) of that section, the amendments made by this Act shall take effect on the date of enactment of the Act.

Subsection (b) provides that, notwithstanding subsection (a) of section 3 of the Act, the United States Postal Service need not make its first payment to the Civil Service Retirement and Disability Fund required by those amendments until fiscal year 1990, but that payment must be sufficient to place the Fund in the position it would have been in had the first payment been made in fiscal year 1989.

UNITED STATES
OFFICE OF PERSONNEL MANAGEMENT
WASHINGTON, D.C. 20415

Office of the Director

JUL 20 1988

Honorable David H. Pryor
Chairman, Subcommittee on Federal Services,
Post Office and Civil Service
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510-6250

Dear Senator Pryor:

This responds to your letter of May 20, 1988, concerning a legislative proposal that would require the D.C. government and the United States Postal Service to fund cost-of-living adjustments (COLA's) paid to their respective annuitants. You have asked for additional information supporting our estimates.

This proposal covers all Civil Service Retirement System annuitants who retired from the D.C. government, the United States Postal Service, and the Post Office Department, and the survivors of those annuitants and of employees who died while employed by those entities. The primary assumptions used in developing the estimated cost of COLA's were derived from 1) a statistical sample of the September 30, 1987, Civil Service Retirement Annuity roll; 2) actuarial factors reflecting demographic characteristics of the retired population and establishing a 15-year amortization schedule; and 3) the economic assumptions provided by the Office of Management and Budget for use in developing the President's FY 1989 Budget. I have enclosed a fact sheet listing these assumptions along with the method used for calculating the payments cited in our transmittal letter.

As stated in my transmittal letter of May 13, 1988, the proposed changes are consistent with the Bipartisan Budget Agreement reached last fall. The example on the attached page indicates a first year liability of $216 million on the part of the Postal Service for FY 1989. (In order to comply with the Bipartisan Budget Agreement, the FY 1989 payment for the Postal Service was deferred until FY 1990, which results in the FY 1990 payment including both the first and second year payments for the FY 1989 COLA as well as the first year payments for the FY 1990 COLA.

CON 181-84-4
May 1988

The first D.C. government payment would be made in FY 1989.) I would be happy to make my technical staff available to answer specific questions regarding the enclosed fact sheet. Your staff may contact Frank Titus at 632-6077.

Sincerely,

Constance Horner
Director

Enclosure

COLA REFORM PROPOSAL
U.S. Postal Service and D.C. Government

Employee annuitants on the roll as of 9/30/87

Agency 1/	Number of annuitants	Average Monthly Annuity	Total Monthly Payments	% of Total
Postal Service	347,323	$1,034	$359,206,530	20.0
D.C. government	9,943	$1,029	$ 10,238,969	.6
Total	1,504,140	$1,146	$1,723,860,230	

1/ Part of the employee annuitant record maintained by OPM includes the agency where the annuitant was last employed prior to retirement. The derived percentages in the last column are applied against the estimated COLA payout for the entire annuity roll to determine COLA amounts attributable to Postal and D.C. annuitants.

Actuarial factors used to determine liability

1. Present Value Factor — 10.78

   This factor, when applied to annual COLA amounts, provides the current value of the liability that will be incurred over the lifetime of the current group of annuitants and survivors for a particular COLA.

2. Amortization Factor -- 10.9

   This factor, when applied against the present value liability, provides the value of 15 equal installments required to fund the liability created by the COLA.

   Both actuarial factors were developed using an interest rate of 5 percent. This interest rate is statutorily mandated for use in static calculations for the Fund.

Annual COLA's used in President's FY 1989 Budget

FY 1989	FY 1990	FY 1991	FY 1992	FY 1993
4.2%	4.0%	3.6%	3.1%	2.6%

Method for calculating payments (example showing Postal Service's FY 89 liability)

Annual value of FY 1989 COLA paid to all employee and survivor annuitants	$1.092	billion
Percentage attributable to Postal Service	20%	
	218.4	million
Present value factor	x 10.78	
Liability created	$2.355	billion
	÷ 10.9	
Annual payment	$ 216.1	million